

Scottish Borders Council Pension Fund

Annual Audit Plan 2022/23 – DRAFT



 AUDIT SCOTLAND

Prepared for Scottish Borders Council Pension Fund
March 2023

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of Scottish Borders Council Pension Fund (the Fund). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual accounts and the provision of an Independent Auditor's Report
- 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 wider scope areas: financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes

Audit Appointment

2. We are pleased to be appointed as the external auditor of the Fund for the period 2022/23 to 2026/27 inclusive. An introduction to the members of your audit team is at [Appendix 1](#).

3. In the first year of the audit appointment, we invest significant time gaining an understanding of your business and identifying and assessing the risks of material misstatement to the financial statements. While we use our initial assessment of risk to inform our planned audit approach, we keep our assessment of risks under review as the audit progresses. We will inform you of any significant changes in assessed risks and any resulting changes in our planned audit work.

4. The audit team will actively engage with you over the course of the audit to ensure our audit work continues to be focused on risk.

Adding value

5. We aim to add value to the Fund through our external audit work by being constructive and forward looking, by attending the meetings of the Pension Fund Committee and Pension Board 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.

Respective responsibilities of the auditor and the Fund

6. The [Code of Audit Practice 2021](#) sets out in detail the respective responsibilities of the auditor and the Fund. Key responsibilities are summarised below.

Auditor responsibilities

7. 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.

8. 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 wider scope arrangements within the Fund. In doing this, we aim to support improvement and accountability.

The Fund's responsibilities

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

10. 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, propriety and regularity that enable them to deliver their objectives.

Financial statements audit planning

Introduction

11. The annual accounts are an essential part of demonstrating the Fund's stewardship of resources and its performance in the use of those resources.

12. We focus our work on the areas of the highest risk. As part of our planning process, we prepare a risk assessment highlighting the audit risks relating to each of the key systems on which the financial statements will be based.

Materiality

13. The concept of materiality is applied by auditors in planning and performing the audit, and in evaluating the effect of any uncorrected misstatements on the financial statements. 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 2022/23 audit

14. 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

2022/23 Quantitative materiality levels for the Fund

Materiality	Amount
Planning materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. Materiality has been set based on our assessment of the needs of the users of the financial statements and the nature of the Funds operations. For the year ended 31 March 2023 we have set our materiality at 1.5% of gross investment assets based on the Q2 2022/23 investment performance reporting.	£12.5 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 assessed performance materiality at 60% of planning materiality.	£7.5 million

Reporting threshold (i.e., clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This is set at 2%.

£0.25 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. 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

17. 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 2](#) 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 2

2022/23 Significant risks of material misstatement to the financial statements

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>1. Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<ul style="list-style-type: none"> Assess the design and implementation of controls over journal entry processing. Test journals at the year-end and post-closing entries and focus on significant risk areas. 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.

Significant risk of material misstatement	Sources of assurance	Planned audit response
management's ability to override controls that otherwise appear to be operating effectively.		<ul style="list-style-type: none"> • Evaluate significant transactions outside the normal course of business. • We will assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.
<p>2. Estimation applied to Level 3 Investments</p> <p>The fund has a significant portfolio of level 3 investments (£324 million at 31 March 2022) for example in unquoted equities where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a significant risk of material misstatement in the financial statements, relating to accuracy.</p>	Unquoted investments are valued by third parties including investment managers and independent valuers who follow detailed professional, accounting and industry codes and guidelines.	<ul style="list-style-type: none"> • Confirmation of year end valuations to valuation reports and/or other supporting documentation, including third party confirmation. • Review user entity controls in relation to the use of the custodian. • Review the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk. • Review the arrangements in place at the Fund to assess investment managers' governance arrangements. • Review the disclosures included in the accounts to ensure these are adequate in directing the user of the accounts to areas with significant judgement and estimation uncertainty.

Source: Audit Scotland

18. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, 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.

19. We have rebutted this risk for the Fund because:

- the split of responsibilities amongst the Fund, its fund managers, its custodian and the bank provide a clear separation of duties reducing the risks relating to investment income
- having considered the value and the nature of contribution income, which is paid over from employers, we have concluded there is not a significant risk in this area.

20. 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.

21. We have rebutted this risk for the Fund because:

- management fees are reported transparently
- pension benefits are the Fund's main expenditure stream. There is no incentive for the Fund to manipulate the amount of benefits paid and we have concluded there is not a significant risk in this area.

22. 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

23. 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.

24. The areas of specific audit focus are:

- **Estimations applied to the International Accounting Standard (IAS) 26 actuarial valuation** - The disclosure of the actuarial valuation of the pension fund liabilities involves a complex accounting estimate. The Pension Fund engage an independent actuary to support the estimation. The valuation is based on a range of financial and demographic estimations about the future, based on a well-established methodology. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.

Wider Scope

Introduction

25. The [Code of Audit Practice](#) sets out the four areas 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 wider scope areas in audited bodies.

26. In summary, the four wider scope areas cover the following:

- **Financial management** – we consider the financial capacity of the Fund and whether there are sound budgetary processes and internal controls in place.
- **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 longer term. We define this as medium term (two to five years) and longer term (longer than five years).
- **Vision, leadership and governance** – we conclude on the arrangements in place to deliver the vision, strategy and priorities adopted by the leader of the Fund. We also consider the effectiveness of the governance arrangements to support delivery.
- **Use of resources to improve outcomes** – we will consider how the Fund demonstrates economy, efficiency and effectiveness through the use of financial and other resources.

Wider scope risks

27. We have identified a wider scope audit risk in the areas, set out in [Exhibit 3](#). This exhibit sets out the risk, sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurances over the risk.

Exhibit 3

2022/23 Wider scope risk

Description of risk	Sources of assurance	Planned audit response
<p>1. Financial sustainability</p> <p>The Fund's investments have reduced from £911 million at 31 March 2022, to £835 million at 30 September 2022. This fall in value of investments relates to the economic climate during 2022.</p> <p>If this fall in value of investments continues throughout the financial year, it may place pressure on contribution rates. Given the current economic environment, there could be challenges around affordability for increased contributions (if required).</p>	<p>Management will continue to work with investment consultants, ISIO, to identify investments which help support income generating assets in line with the Statement of Investment Principles 2022.</p> <p>Management will work with the actuary, Hymans Robertson, regarding appropriate contribution rates.</p>	<ul style="list-style-type: none"> • Review the performance of the Fund through the year through ISIO quarterly performance reports. • Review investment performance against the benchmark returns set for the year in the Statement of Investment Principles 2022. • Evaluating the arrangements in place at the Fund for monitoring performance against its financial plans, including funding strategy. We will consider how the Fund monitors its investment portfolio to ensure investment risk is managed while delivering financial returns.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

28. Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 4](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

29. 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.

30. 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.

31. [Exhibit 4](#) outlines the target dates for our audit outputs, and we aim to issue the independent auditor's report by the statutory deadline of 30 September 2023.

Exhibit 4 2022/23 Audit outputs

Audit Output	Target date	Pension Fund Committee and Pension Board - Date
Annual Audit Plan	27/02/2023	09/03/2023
Independent Auditor's Report	September 2023	September 2023
Annual Audit Report	September 2023	September 2023

Source: Audit Scotland



Timetable

32. 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 5](#) that has been discussed with management.

33. 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. We are identifying ways to work more efficiently to expedite the 2022/23 audits whilst at the same time maintaining high standards of quality.

34. We intend to take a hybrid approach to the 2022/23 audit with a blend of onsite and remote working, where this works with the body's own arrangements. We will continue to work closely with management to identify the most efficient approach as appropriate and will keep timeframes and logistics for the completion of the audit under review. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 5 Proposed annual accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual accounts by those charged with governance	22 June 2023
Latest submission date for the receipt of the unaudited annual accounts with complete working papers package.	30 June 2023
Latest date for final clearance meeting with the Interim S95 Officer	September 2023
Issue of draft Letter of Representation and proposed Independent Auditor's Report	September 2023
Agreement of audited and unsigned annual accounts	September 2023
Issue of Annual Audit Report to those charged with governance.	End September 2023
Signed Independent Auditor's Report	End September 2023

Source: Audit Scotland

Audit fee

35. In determining the audit fee, we have taken account of the risk exposure of the Fund and the planned management assurances in place. The proposed audit fee for 2022/23 is £24,880 as set out in [Exhibit 6](#).

36. Our fees have increased in 2022/23 and this is a reflection of the current audit market and the rising costs in delivering high quality audit work. There are increased regulatory expectations and risks placed on audit and its quality, as well as a widening in the scope of work audit must cover.

Exhibit 6 Audit fees (including VAT)

Fee component	Fees (£)
External Auditor Remuneration	43,050
Pooled costs	0
Contribution to Audit Scotland costs	1,630
Contribution to Performance and Best Value	0
Sectoral Cap Adjustment	-19,800
Total 2022/23 fee	24,880

Source: Audit Scotland

37. Details of the components of the Audit Fee have been separately communicated to Management. In setting the fee for 2022/23 auditors have the opportunity for agreeing local increases from the baseline fee depending on the risks and anticipated audit work identified during audit planning. The above proposed fee has been retained at the baseline fee. We have assumed that the Fund has sound governance arrangements in place and operating effectively and will prepare comprehensive and accurate draft financial statements and meets the agreed timetable for the audit. It also assumes there is no major change in respect of the scope of the work in year. Where our audit cannot proceed as planned a supplementary fee may be levied.

Other matters

Internal audit

38. It is the responsibility of the Fund to establish adequate internal audit arrangements. Scottish Borders Council's Internal Audit Service provide internal audit services on behalf of the Fund. We will review the internal audit plan and the results of internal audit's work.

39. We will consider the findings from internal audit reports where they raise issues that could have an impact on the financial statements or our wider scope responsibilities, however, we will not place formal reliance on the work of internal audit in 2022/23.

Independence and objectivity

40. 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.

41. 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 Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

42. The appointed auditor for the Fund is John Boyd, 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

43. Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. High quality audits provide assurance, add value and can support public bodies to achieve their objectives.

44. Until 2021/22, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC (UK) 1). This set out an audit practice's responsibilities for its system of quality control for audits.

45. ISQC(UK) 1 has been replaced by two new audit quality standards: Internal Standards on Quality Management (ISQM (UK) 1), applicable from 15 December 2022, and (ISQM(UK) 2) effective for the 2023/24 audits. Work is underway at Audit Scotland to meet the requirements of these quality standards.

46. Audit Scotland is committed to delivering high quality audits. 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 supplementary 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 England and Wales (ICAEW) have been commissioned to carry out external quality reviews.

47. 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.

Appendix 1. Your audit team

48. The senior team involved in the external audit of the Fund have significant experience in public sector audit

John Boyd
Audit Director
jboyd@audit-scotland.gov.uk

John is the Audit Director, with overall responsibility for the Audit Engagement. John has considerable audit experience across public sector audits including local government, pension funds, health and central government sectors. John is the Audit Scotland Audit Services Group Lead for local authority and pension fund audits and is a member of the Local Authority (Scotland) Accounting Advisory Committee (LASAAC).

Stephanie Harold
Senior Audit Manager
sharold@audit-scotland.gov.uk

Stephanie has over 11 years of public sector audit experience and has delivered external audit services to a range of bodies including local authorities, health boards and central government bodies.

Emma Carrigan
Senior Auditor
ecarrigan@audit-scotland.gov.uk

Emma has considerable experience in planning and delivering audits across the public sector. Emma will manage the team and work alongside the Senior Audit Manager and Audit Director to deliver the audit.

49. The local audit team is supported by a specialist technical accounting team, all of whom have significant experience of public bodies and work with accounting regulatory bodies.

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk