Strathclyde Pension Fund

Annual Audit Plan 2021/22 – DRAFT



AUDIT SCOTLAND

Prepared for Strathclyde Pension Fund

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2021/22 external audit of Strathclyde 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 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 that frame the wider scope of public sector audit
- review the Fund's participation in the National Fraud Initiative.

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 Strathclyde Pension Fund 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, propriety and regularity 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. The materiality values for the Fund are set out in Exhibit 1.

Exhibit 1
2021/22 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. It has been set at 1% of net assets for the year ended 31 March 2022 based on the latest audited accounts for 2020/21.	£264 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 75% of planning materiality.	£198 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. We have set this at 1% of planning materiality, with a maximum threshold of £250,000.	£0.250 million

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 benefits expenditure (payments to pensioners) and contributions received (income from employers and members) are 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	Amount
Specific materiality – We have set this at 1% of payments to pensioners for the year ended 31 March 2021 based on the latest audited accounts for 2020/21	£7 million
Specific performance materiality – Using our professional judgement we have set performance materiality at 75% of the specific materiality.	£5.5 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
1. Risk of material misstatement due to fraud caused by the management override of controls 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.	Owing to the nature of this risk, assurances from management are not applicable in this instance	Detailed testing of journal entries. Assessment of the estimation methodology applied by the Fund and the reasonableness of accounting estimates within the financial statements. Focused testing of accruals and prepayments. Evaluation of significant transactions outside the normal course of business.

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 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. 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
- further controls are in place around contribution income which is paid over from employers.

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 risk for the Fund because:

- investments are managed by external investment managers and recorded by the Fund's custodian

- pension benefits are the Fund's main expenditure stream. There is no real incentive for the Fund to manipulate the amount of benefits paid

- controls are in place to ensure the correct amounts of benefits are paid and second officer checks are in place.

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 other areas of specific audit focus are:

- **Estimations applied to level 3 investments:** The pension fund has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a risk of material misstatement in the financial statement

- **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.

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.

Audit dimensions

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.

Exhibit 4
Audit dimensions



Source: Code of Audit Practice

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 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. Based on our planning work carried out to date we have not identified any audit dimension risks.

Reporting arrangements, timetable, and audit fee

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.

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.

Exhibit 5
2020/21 Audit outputs

Audit Output	Target date	Committee
Annual Audit Plan	30/03/2022	21 June 2022*
Independent Auditor's Report	31/10/2022	To be confirmed
Annual Audit Report	31/102022	To be confirmed

Source: Audit Scotland

* Progress report provided to Strathclyde Pension Fund Committee 2 March 2022 as part of Finance update paper

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	21June 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 the Director of Finance	October 2022*
Issue of Letter of Representation and proposed Independent Auditor's Report	October 2022*
Agreement of audited and unsigned annual accounts	October 2022*
Issue of Annual Audit Report to those charged with governance	October 2022*
Signed Independent Auditor's Report	October 2022*
*We will agree specific dates with auditors as the audit progresses	

Source: Audit Scotland

Audit fee

34. The proposed audit fee for the 2021/22 audit of the Fund is £60,030 (2020/21: £58,400). 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.

Other matters

Internal audit

36. Internal audit is provided by the internal auditors of Glasgow City Council. As part of our planning process we carry out an annual assessment of the internal audit function to ensure that it operates in accordance with the main requirements of the Public Sector Internal Audit Standards (PSIAS). ISA 610 requires an assessment on whether the work of the internal audit function can be used for the purposes of external audit. This includes:

- the extent to which the internal audit function's organisational status and relevant policies and procedures support the objectivity of the internal auditors
- the level of competence of the internal audit function
- whether the internal audit function applies a systematic and disciplined approach, including quality control.

37. Our review of the internal audit function concluded that it continues to have sound documentation standards and reporting procedures in place, and it complies with PSIAS requirements.

38. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to use the work of internal audit wherever possible to avoid duplication. We have considered the findings of the work of internal audit as part of our planning to ensure the total resource is used efficiently and effectively.

Independence and objectivity

39. 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 Executive Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

40. The engagement lead (i.e. appointed auditor) for the Fund is John Cornett, 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

41. 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.

42. 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.

43. 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.

Strathclyde Pension Fund

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