

# Shetland Islands Pension Fund

Annual Audit Plan 2022/23



 AUDIT SCOTLAND

Prepared for Shetland Islands Pension Fund

April 2023

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# Introduction

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## Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of Shetland Islands 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.

## 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. 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 meetings of the Pension Fund Committee 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.

## Communication of fraud or suspected fraud

**11.** In line with ISA 240, in presenting this plan to the Pension Fund Committee we seek confirmation from those charged with governance of any instances of actual, suspected, or alleged fraud that should be brought to our attention. Should members of the Pension Fund Committee or Pension Board have any such knowledge or concerns relating to the risk of fraud within the Fund or their service organisations, we invite them to communicate this to the appointed auditor for consideration.

# Financial statements audit planning

## Introduction

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

**13.** 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

**14.** 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

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

## Exhibit 1

### 2022/23 Materiality levels for the Fund

Materiality	Amount
<b>Planning materiality</b> – 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 2% of gross investment assets based on the audited financial statements for 2021/22.	£13 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 assessed performance materiality at 60% of planning materiality.	£7.8 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 threshold has been capped at £250,000 for 2022/23. £250 thousand

Source: Audit Scotland

## Lower specific materiality levels for the 2022/23 audit

**16.** 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.

**17.** We recognise that transactions with members (contributions receivable, benefits payable and transfers out of/into the fund account) are likely to be of key interest to the users of the financial statements and we set specific materiality levels as shown in [Exhibit 2](#).

### Exhibit 2

#### 2022/23 Lower specific materiality levels for the Fund

Materiality	Amount
<b>Specific materiality</b> – It has been set at 10% of total additions for the year ended 31 March 2023 based on the latest audited financial statements for 2021/22.	£2.25 million
<b>Specific performance materiality</b> – Using our professional judgement, we have calculated specific performance materiality at 60% of the specific materiality.	£1.35 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. This threshold has been capped at £250,000 for 2022/23.	£250 thousand

Source: Audit Scotland

## Significant and non-significant risks of material misstatement

**18.** 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 and a review of supporting information.

**19.** Based on our risk assessment process, we identified the following significant and non-significant risks of material misstatement to the financial statements. Significant risks are risks which have the greatest impact on our planned audit

procedures. Other non-significant risks of material misstatement are risks that require a specific audit response in addition to our standard 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

#### 2022/23 Risks of material misstatement to the financial statements

Risk of material misstatement	Sources of assurance	Planned audit response
<b>Significant risk of material misstatement to the financial statements</b>		
<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 in this instance</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 any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> <li>• Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</li> <li>• Focussed testing of accounting accruals and prepayments</li> </ul>
<b>Other non-significant risks of material misstatement</b>		
<p><b>2. Actuarial valuation of pension liability</b></p>	<p>Valuations are reviewed by officers for reasonableness including confirmation of</p>	<ul style="list-style-type: none"> <li>• Assess the competence, capabilities, and objectivity of the actuary in line with ISA 500.</li> </ul>

Risk of material misstatement	Sources of assurance	Planned audit response
<p>The annual accounts include a disclosure note setting out the Fund's liability for future retirement benefits. This information is provided by the Fund's actuary.</p> <p>The actuary's 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.</p>	<p>the accuracy of the source data used to produce them.</p>	<ul style="list-style-type: none"> <li>• Review the information provided to the actuary by the Fund.</li> <li>• Review the assumptions used by the actuary to reach the valuation of future retirement benefits.</li> <li>• Review officers' arrangements for ensuring the completeness and accuracy of professional estimations for pensions.</li> </ul>
<p><b>3. Level 3 investment assets valuation</b></p> <p>These investments represent 11 per cent of the Fund's investments and are not based on observable market data but rely on investment manager valuations involving significant application of judgement which might be impacted by delays in valuation data and reaction to environmental factors.</p> <p>The subjectivity involved represents increased risk of material misstatement in the financial statements</p>	<p>Valuations are reviewed by officers for reasonableness including confirmation of the accuracy of the source data used to produce them.</p>	<ul style="list-style-type: none"> <li>• Assess the competence, capabilities, and objectivity of the Fund Managers in line with ISA 500.</li> <li>• Review previous auditor work on balances brought forward.</li> <li>• Review post year end valuation reports.</li> <li>• Carry out focused valuation testing on a sample of investments examining the valuation methodology.</li> </ul>

Source: Audit Scotland

**20.** 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. We have considered the risk of fraud over income recognition (ISA 240). We also considered the risk of fraud over expenditure, and the risk of external fraud (in accordance with Practice Note



10 [Audit of Financial Statements and Regularity of Public Sector Bodies in the UK]).

**21.** We have rebutted the presumption that a material risk exists, with the exception of management override, as noted above. This is on the basis that:

- there are generally no incentives for staff to commit fraudulent financial reporting
- income and expenditure arising from dealing with members is in accordance with regulations with low inherent risk and effective internal control arrangements
- the Fund appoints a global custodian to safeguard the assets of the fund and ensure that all investment income and transactions are brought to account
- evidence of external fraud from the National Fraud Initiative does not indicate material risks
- experience in the sector and of the audit of the Fund, including review of past misstatements.

**22.** Our audit testing is directed towards testing significant and unusual transactions and towards assessing accounting estimates to address any residual risk, as part of our standard fraud procedures. We have not, therefore, incorporated specific work into our audit plan in these areas in addition to our standard audit procedures.

### **Revisions to ISA (UK) 315 on auditors' responsibility to identify and assess the risks of material misstatement**

**23.** Revised ISA 315 requires auditors to have a greater understanding of the IT systems bodies use to prepare their financial statements and the risks that arise from the use of these systems. Our work in this area is ongoing and we will consider the systems used by the Fund under service arrangements. If we identify any risks of material misstatement from this work, we will report these, along with our audit response and the results of any testing, in our annual audit report.

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# Wider Scope

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## Introduction

**24.** 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.

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

- **Financial management** – means having sound financial control processes. We will consider these arrangements and comment on financial management in our Annual Audit Report.
- **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, based on triennial and other valuation reviews and based on actuary's assessments
- **Vision, leadership and governance** – we conclude on the arrangements in place to deliver the Fund's vision, strategy and priorities adopted by the leader of the Fund. We also consider the effectiveness of the Fund's governance arrangements.
- **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 areas of focus

**26.** Our planned work on our wider scope responsibilities is risk based and proportionate. We have not identified any additional local wider scope risks for the 2022/23 audit of Shetland Islands Pension Fund. Progress on the outstanding recommendations identified in prior years will be followed-up with management during the course of the 2022/23 audit.

### Climate Change

**27.** The Auditor General and Accounts Commission are developing a programme of work on climate change. In 2022/23, we will gather information on the Fund's arrangements for responding to climate change, including areas such as the extent of ethical and environmental considerations in investments.

### Cyber Security

**28.** As noted in paragraph 23, we are undertaking a wider review of ICT systems and in 2022/23, we will consider Shetland Islands Pension Fund's arrangements for managing and mitigating cyber security risks.

# Reporting arrangements, timetable, and audit fee

## Reporting arrangements

**29.** 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](http://www.audit-scotland.gov.uk).

**30.** 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.

**31.** 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.

**32.** [Exhibit 4](#) outlines the target dates for our audit outputs.

## Exhibit 4

### 2022/23 Audit outputs

Audit Output	Target date	Pension Fund Committee Date
Annual Audit Plan	28 April 2023	16 May 2023
Independent Auditor's Report	31 October 2023	13 November 2023
Annual Audit Report	31 October 2023	13 November 2023

Source: Audit Scotland



**33.** The Local Authority Accounts (Scotland) Regulations 2014 require local authorities to 'aim to approve the audited accounts for signature no later than 30 September immediately following the financial year to which the accounts relate' and that the signed accounts 'must be published no later than 31 October'. Due to the legacy of the late completion of prior year audits due to Covid-19 and ongoing resourcing challenges within Audit Scotland, we are unable to complete Shetland Islands Pension Fund's audit by the 30 September but aim to have it completed in time to publish the audited accounts by 31 October.

**34.** We acknowledge that this planned timetable is determined by the availability of the audit process and not by the Fund, which proposes to present unaudited accounts for audit by the 30 June 2023.

## Timetable

**35.** 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.

### Exhibit 5 Proposed annual accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual accounts by those charged with governance	26 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 Director of Finance (or equivalent)	19 October 2023
Issue of draft Letter of Representation and proposed Independent Auditor's Report	26 October 2023
Agreement of audited and unsigned annual accounts	26 October 2023
Issue of Annual Audit Report to those charged with governance	13 November 2023
Signed Independent Auditor's Report	13 December 2023 (council meeting)

Source: Audit Scotland

**36.** We intend to take a remote working approach to the 2022/23 audit. We will continue to work closely with management to identify the most efficient approach 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.

## Audit fee

**37.** 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 £35,170 (2021/22: £31,250).

**38.** Fees have increased in 2022/23 and this reflects 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.

**39.** In setting the fee for 2022/23 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.

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# Other matters

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## Internal audit

**40.** It is the responsibility of the Fund to establish adequate internal audit arrangements. The Fund's internal audit function is provided by Glasgow City Council's internal audit department. We have reviewed internal audit's plan as part of our planning process.

**41.** While we are not planning to place formal reliance on the work of internal audit in 2022/23, we will review internal audit reports and assess the impact of the findings on our financial statements and wider scope audit responsibilities.

## Independence and objectivity

**42.** 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.

**43.** 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.

**44.** Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. The appointed auditor for the Fund is Brian Howarth, Audit Director. We are not aware of any such relationships pertaining to the audit of the Fund.

## Quality control

**45.** 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. 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.

**46.** 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.

**47.** 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.

**48.** 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.



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# Appendix 1. Your audit team

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



**Brian Howarth, Audit Director**

Brian is the appointed auditor for a portfolio of health, local government and central government bodies, including Shetland Islands Pension Fund, Shetland Islands Council, Shetland Islands IJB, NHS Shetland and Tayside Pension Fund,. He has 30 years experience of public sector audit with Audit Scotland and is a member of the Chartered Institute of Management Accountants. Most recently Brian was the appointed auditor for Fife Pension Fund, five councils, five IJBs and two NHS bodies.



**Stephen O'Hagan, Senior Audit Manager**

Stephen joined Audit Scotland's predecessor organisation as a senior auditor over 25 years ago and has been a senior audit manager for over 17 years. He has extensive experience in the delivery of local and central government sectors, most recently leading on a portfolio of audits including Glasgow City Council and Strathclyde Pension Fund.



**Wojciech Kuzma, Senior Auditor**

Wojciech joined Audit Scotland's Professional Trainee scheme in 2015 and qualified as a Chartered Accountant in 2019. Most recently Wojciech worked on European Agricultural Funds Accounts and Food Standards Scotland audits. Prior to this he worked on several other audits in the Central Government sector.



**Daniel Cunningham, Auditor**

Daniel joined Audit Scotland in 2019 as a professional trainee. He has worked primarily on NHS Borders audit over the past four years, as well as on a variety of central government bodies including National Records of Scotland and National Library of Scotland.

**50.** 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.

# Shetland Islands Pension Fund

## Annual Audit Plan 2022/23

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)

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