

## **Item: 4**

**Pension Fund Sub-committee: 16 November 2022.**

**Orkney Islands Council Pension Fund.**

**Audit Report to those charged with Governance.**

**Report by Corporate Director for Enterprise and Sustainable  
Regeneration.**

### **1. Purpose of Report**

To consider the External Auditor's Annual Audit Report to Members and the Controller of Audit to those charged with governance of the Orkney Islands Council Pension Fund.

### **2. Recommendations**

The Sub-committee is invited to note:

#### **2.1.**

That Audit Scotland, as the Council's external auditors, have concluded their audit of the Orkney Islands Council Pension Fund's Annual Report and Accounts for the year ended 31 March 2022.

#### **2.2.**

That Audit Scotland has provided an unmodified certificate on the Pension Fund's Annual Report and Accounts for the year ended 31 March 2022.

#### **2.3.**

That the draft audit certificate states that the accounts have been properly prepared in accordance with applicable law, accounting standards and other reporting requirements.

#### **2.4.**

That, during the course of the audit, a number of presentational, consistency and disclosure errors were identified within the financial statements, which have been adjusted in the final accounts.

#### **2.5.**

That no material weaknesses in the accounting and internal control systems relating to the Pension Fund were identified during the audit.

## **2.6.**

Audit Scotland's covering letter in respect of the Orkney Islands Council Pension Fund Annual Audit Report, attached as Appendix 1 to this report.

## **2.7.**

Orkney Island's Council's Letter of Representation to Audit Scotland in connection with their audit of the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2022, attached as Appendix 2 to this report.

## **2.8.**

The Annual Audit Report to Members of the Pension Fund Sub-committee and the Controller of Audit, in respect of the Orkney Islands Council Pension Fund, attached as Appendix 3 to this report.

## **3. External Audit**

The main elements of the audit work carried out by Audit Scotland for financial year 2021/22 are as follows:

- Audit of the annual report and accounts and provision of an opinion on whether:
  - They give a true and fair view in accordance with applicable law and the 2021/22 Code of the financial transactions of the fund during the year ended 31 March 2022 and of the amount and disposition at that date of its assets and liabilities.
  - They have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as interpreted and adapted by the 2021/22 Code.
  - The accounts have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.
- A review and assessment of the Pension Fund governance and performance arrangements in a number of key areas including a review of:
  - Standing orders.
  - Codes of Conduct for officers and members.
  - Whistleblowing Policy.
  - Anti-fraud and corruption arrangements.
  - Financial Regulations.
  - Systems of internal control.
  - Internal Audit.
  - Arrangements for ensuring the proper conduct of affairs of the Pension Fund in accordance with the law and the requirements of the Pension Regulator.

- Commitment to transparency.
- Provision of an independent auditor's report to the Orkney Islands Council Pension Fund and the Accounts Commission for Scotland that the audit of the financial statements has been completed in accordance with applicable statutory requirements, including an opinion on those financial statements.

## **4. External Audit Findings**

### **4.1.**

The auditors have reported that their independent auditor's report, dated 16 November 2022, contains an unmodified audit opinion on the Statement of Accounts for the Pension Fund for the year ended 31 March 2022. The independent auditor's report, attached as Appendix 1 to this report, certifies that the accounts have been properly prepared in accordance with applicable law, accounting standards and other reporting requirements.

### **4.2.**

As part of the completion of the audit, Audit Scotland seeks written assurances from the Section 95 Officer on aspects of the financial statements and judgements and estimates made. The Orkney Islands Council letter of representation is attached as Appendix 2 to this report.

### **4.3.**

The auditors identified a number of presentational adjustments in the draft financial statements during the course of the audit.

### **4.4.**

No material weaknesses in the accounting and internal control systems were identified during the audit.

### **4.5.**

No material adjustments were required.

### **4.6.**

The Annual Audit Report to Members and the Controller of Audit of the Orkney Islands Council Pension Fund, is attached as Appendix 3 to this report.

## **5. Corporate Governance**

This report relates to the Council complying with its governance and financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

## 6. Financial Implications

The audit fee for the audit of the Pension Fund's annual report and accounts was £22,090 which is £600 more than the fee for the 2020/21 audit.

## 7. Legal Aspects

### 7.1.

The Local Government Pension Scheme is a funded defined benefit scheme, established under the Superannuation Act 1972, with pensioners receiving index-linked pensions. It is administered by Orkney Islands Council in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018 (as amended) and is contracted out of the State Second Pension. The Pension Fund is subject to a triennial valuation by an independent, qualified Actuary, whose report indicates the required future employer's contributions.

### 7.2.

Local authorities have a duty under section 12 of the Local Government in Scotland Act 2003 to observe proper accounting practices.

### 7.3.

The Local Government Pension Scheme Amendment (Scotland) Regulation 2010 (SSI 2010/234) require a pensions fund annual report and separate audit.

## 8. Contact Officers

Gareth Waterson, Corporate Director for Enterprise and Sustainable Regeneration, extension 2103, Email [gareth.waterson@orkney.gov.uk](mailto:gareth.waterson@orkney.gov.uk).

Erik Knight, Head of Finance, extension 2127, Email [erik.knight@orkney.gov.uk](mailto:erik.knight@orkney.gov.uk).

Shonagh Merriman, Service Manager (Corporate Finance), extension 2105, Email [shonagh.merriman@orkney.gov.uk](mailto:shonagh.merriman@orkney.gov.uk).

## 9. Appendices

Appendix 1: Audit Scotland ISA 260 covering letter for the Orkney Islands Council Pension Fund Annual Audit Report.

Appendix 2: Orkney Islands Council's Letter of Representation to Audit Scotland in connection with their audit of the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2022.

Appendix 3: Audit Scotland Annual Report to Members and the Controller of Audit of the Orkney Islands Council Pension Fund Annual Report and Accounts (ISA 260 Report).

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## Pension Fund Sub Committee and Pension Board

16 November 2022

### Orkney Islands Council Pension Fund Audit of 2021/22 annual accounts

#### Independent auditor's report

1. Our audit work on the 2021/22 annual accounts is now substantially complete. Subject to [the satisfactory conclusion of the outstanding matters referred to later in this letter and receipt of a revised set of annual accounts for final review, we anticipate being able to issue unqualified audit opinions in the independent auditor's report on 16 November 2022 (the proposed report is attached at [Appendix A](#)).

#### Annual audit report

2. Under International Standards on Auditing in the UK, we report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. We present for the Pension Fund Sub Committee consideration our draft annual report on the 2021/22 audit. The section headed "Significant findings from the audit in accordance with ISA 260" sets out the issues identified in respect of the annual accounts.

3. The report also sets out conclusions from our consideration of the four audit dimensions that frame the wider scope of public audit as set out in the Code of Audit Practice.

4. This report will be issued in final form after the annual accounts have been certified.

#### Unadjusted misstatements

5. We also report to those charged with governance all unadjusted misstatements which we have identified during our audit, other than those of a trivial nature and request that these misstatements be corrected. We have no unadjusted misstatements to be corrected.

#### Fraud, subsequent events and compliance with laws and regulations

6. In presenting this report to the Pension Fund Sub Committee we seek confirmation from those charged with governance of any instances of any actual, suspected or alleged fraud; any subsequent events that have occurred since the date of the financial statements; or material non-compliance with laws and regulations affecting the entity that should be brought to our attention.

#### Representations from Section 95 Officer

7. As part of the completion of our audit, we are seeking written representations from the Section 95 Officer on aspects of the annual accounts, including the judgements and estimates made.

**8.** A draft letter of representation is attached at [Appendix B](#). This should be signed and returned to us by the Section 95 Officer with the signed annual accounts prior to the independent auditor's report being certified.

## **Appendix A: Proposed Independent Auditor's Report**

### **Independent auditor's report to the members of Orkney Islands Council as administering authority for Orkney Islands Council Pension Fund and the Accounts Commission**

#### **Reporting on the audit of the financial statements**

##### **Opinion on financial statements**

I certify that I have audited the financial statements in the annual report of Orkney Islands Council Pension Fund (the fund) for the year ended 31 March 2022 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and notes to annual accounts, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 (the 2021/22 Code).

In my opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2021/22 Code of the financial transactions of the fund during the year ended 31 March 2022 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with UK adopted international accounting standards, as interpreted and adapted by the 2021/22 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

##### **Basis for opinion**

I conducted my audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the [Code of Audit Practice](#) approved by the Accounts Commission for Scotland. My responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of my report. I was appointed by the Accounts Commission on 10 April 2017. The period of total uninterrupted appointment is six years. I am independent of the fund in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and I have fulfilled my other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the council. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

##### **Conclusions relating to going concern basis of accounting**

I have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work I have performed, I have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the fund's

ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

These conclusions are not intended to, nor do they, provide assurance on the fund's current or future financial sustainability. However, I report on the fund's arrangements for financial sustainability in a separate Annual Audit Report available from the [Audit Scotland website](#).

### **Risks of material misstatement**

I report in my Annual Audit Report the most significant assessed risks of material misstatement that I identified and my judgements thereon.

### **Responsibilities of the Corporate Director of Enterprise and Sustainable Regeneration and Orkney Islands Council Pension Fund Sub Committee for the financial statements**

As explained more fully in the Statement of Responsibilities, the Corporate Director of Enterprise and Sustainable Regeneration is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Corporate Director of Enterprise and Sustainable Regeneration determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Corporate Director of Enterprise and Sustainable Regeneration is responsible for assessing the fund ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention to discontinue the fund's operations.

The Orkney Islands Council Pension Fund Sub Committee is responsible for overseeing the financial reporting process.

### **Auditor's responsibilities for the audit of the financial statements**

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. I design procedures in line with my responsibilities outlined above to detect material misstatements in respect of irregularities, including fraud. Procedures include:

- obtaining an understanding of the applicable legal and regulatory framework and how the fund is complying with that framework;
- identifying which laws and regulations are significant in the context of the fund;
- assessing the susceptibility of the financial statements to material misstatement, including how fraud might occur; and
- considering whether the audit team collectively has the appropriate competence and capabilities to identify or recognise non-compliance with laws and regulations.



The extent to which my procedures are capable of detecting irregularities, including fraud, is affected by the inherent difficulty in detecting irregularities, the effectiveness of the fund's controls, and the nature, timing and extent of the audit procedures performed.

Irregularities that result from fraud are inherently more difficult to detect than irregularities that result from error as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of my auditor's report.

## Reporting on other requirements

### Other information

The Corporate Director of Enterprise and Sustainable Regeneration is responsible for other information in the annual report. The other information comprises the Management Commentary, Statement of Responsibilities for the Annual Accounts, Remuneration Report Annual Governance Statement, Governance Compliance Statement and other reports included in the annual report other than the financial statements and my auditor's report thereon.

My responsibility is to read all the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If I identify such material inconsistencies or apparent material misstatements, I am required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on the Management Commentary, Annual Governance Statement and Governance Compliance Statement to the extent explicitly stated in the following opinions prescribed by the Accounts Commission.

### **Opinions prescribed by the Accounts Commission on the Management Commentary, Annual Governance Statement and Governance Compliance Statement**

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016): and

- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

### **Matters on which I am required to report by exception**

I am required by the Accounts Commission to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.

### **Conclusions on wider scope responsibilities**

In addition to my responsibilities for the annual accounts, my conclusions on the wider scope responsibilities specified in the Code of Audit Practice, including those in respect of Best Value, are set out in my Annual Audit Report.

### **Use of my report**

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Gillian Woolman MA FCA CPFA

Audit Director

Audit Scotland

4<sup>th</sup> Floor

102 West Port

Edinburgh

EH3 9DN

## **Appendix B: Letter of Representation (ISA 580)**

Gillian Woolman, Audit Director  
Audit Scotland  
4th Floor  
102 West Port  
Edinburgh  
EH3 9DN

Dear Gillian

### **Orkney Islands Council Pension Fund Annual report and accounts 2021/22**

- 1.** This representation letter is provided about your audit of the annual accounts of Orkney Islands Council Pension Fund for the year ended 31 March 2022 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the financial reporting framework, and for expressing other opinions on the remuneration report, management commentary and annual governance statement.
- 2.** I confirm to the best of my knowledge and belief and having made appropriate enquiries as I consider necessary, the following representations given to you in connection with your audit of Orkney Islands Council Pension Fund annual accounts for the year ended 31 March 2022.

#### **General**

- 3.** Orkney Islands Council Pension Fund and I have fulfilled our statutory responsibilities for the preparation of the 2021/22 annual accounts. All the accounting records, documentation and other matters which I am aware are relevant to the preparation of the annual accounts have been made available to you for the purposes of your audit. All transactions undertaken by Orkney Islands Council Pension Fund have been recorded in the accounting records and are properly reflected in the financial statements.
- 4.** I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those reported by you.

#### **Financial Reporting Framework**

- 5.** The annual accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 (2021/22 accounting code), and in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003 and The Local Authority Accounts (Scotland) Regulations 2014.
- 6.** In accordance with the 2014 regulations, I have ensured that the financial statements give a true and fair view of the financial position of the Orkney Islands Council Pension Fund at 31 March 2022 and the transactions for 2021/22.

#### **Accounting Policies and Estimates**

- 7.** All significant accounting policies applied are as shown in the notes to the financial statements. The accounting policies are determined by the 2021/22 accounting code where applicable. Where the code does not specifically apply I have used judgement in developing and applying an accounting policy that results in information that is relevant and reliable. All

accounting policies applied are appropriate to Orkney Islands Council Pension Fund circumstances and have been consistently applied.

**8.** The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. Judgements used in making estimates have been based on the latest available, reliable information. Estimates have been revised where there are changes in the circumstances on which the original estimate was based or as a result of new information or experience.

### **Going Concern Basis of Accounting**

**9.** I have assessed Orkney Islands Council Pension Fund's ability to continue to use the going concern basis of accounting and have concluded that it is appropriate. I am not aware of any material uncertainties that may cast significant doubt on Orkney Islands Council Pension Fund's ability to continue as a going concern.

### **Assets**

#### **Investments**

**10.** For the year ended 31 March 2022, the amounts included in the net assets statements reflect investments managed/held both internally and externally by appointed fund managers and the global custodian on behalf of the funds. Amounts have been calculated in accordance with approved bases of valuation and fairly represent the values at 31 March 2022. In making these assertions I am reliant on the opinions of the appointed fund managers. As far as we can reasonably ascertain, all assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

#### **Banking and Cash Flow Arrangements**

**11.** The pension funds maintain separate bank accounts and while these accounts form part of Orkney Islands Councils treasury management arrangements, the pension fund can demonstrate that there is no borrowing from the administering authority. Amounts due to the administering authority to cover daily cash flows such as payments through the council's systems are reimbursed on a regular basis.

#### **Other Current Assets**

**12.** On realisation in the ordinary course of the funds' business, the other current assets in the Net Assets Statements are expected, in my opinion, to produce at least the amounts at which they are stated. In particular adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

#### **Liabilities**

**13.** All liabilities at 31 March 2022 of which I am aware have been recognised in the annual accounts.

**14.** Provisions have been recognised in the financial statements for all liabilities of uncertain timing or amount at 31 March 2022 of which I am aware where the conditions specified in the 2021/22 accounting code have been met. The amount recognised as a provision is the best estimate of the expenditure likely to be required to settle the obligation at 31 March 2022. Where the effect of the time value of money is material, the amount of the provision has been discounted to the present value of the expected payments.

**15.** Provisions recognised in previous years have been reviewed and adjusted, where appropriate, to reflect the best estimate at 31 March 2022 or to reflect material changes in the assumptions underlying the calculations of the cash flows.

**16.** The pension assumptions made by the actuary in the IAS 26 report for Orkney Islands Council Pension Fund have been considered and I confirm that they are consistent with management's own view.

**17.** There are no plans or intentions that are likely to affect the carrying value or classification of the liabilities recognised in the financial statements.

### **Contingent liabilities**

**18.** There are no significant contingent liabilities, other than those disclosed in Note 31 to the financial statements, arising either under formal agreement or through formal undertakings requiring disclosure in the accounts. All known contingent liabilities have been fully and properly disclosed, including any outstanding legal claims which have not been provided under the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 and IAS 37.

### **Fraud**

**19.** I have provided you with all information in relation to:

- my assessment of the risk that the financial statements may be materially misstated because of fraud
- any allegations of fraud or suspected fraud affecting the financial statements
- fraud or suspected fraud that I am aware of involving management, employees who have a significant role in internal control, or others that could have a material effect on the financial statements.

### **Laws and Regulations**

**20.** I have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

### **Related Party Transactions**

**21.** All material transactions with related parties have been appropriately accounted for and disclosed in the financial statements in accordance with the 2021/22 accounting code. I have made available to you the identity of all the Orkney Islands Council Pension Fund's related parties and all the related party relationships and transactions of which I am aware.

### **Management commentary**

**22.** I confirm that the Management Commentary has been prepared in accordance with the statutory guidance and the information is consistent with the financial statements.

### **Corporate Governance**

**23.** I confirm that the Orkney Islands Council Pension Fund has undertaken a review of the system of internal control during 2021/22 to establish the extent to which it complies with proper practices set out in the Delivering Good Governance in Local Government: Framework 2016. I have disclosed to you all deficiencies in internal control identified from this review or of which I am otherwise aware.

**24.** I confirm that the Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government: Framework 2016 and the information is consistent with the financial statements. There have been no changes in the corporate

governance arrangements or issues identified, since 31 March 2022, which require to be reflected.

### **Events Subsequent to the Date of the Balance Sheet**

**25.** All events subsequent to 31 March 2022 for which the 2021/22 accounting code requires adjustment or disclosure have been adjusted or disclosed.

Yours sincerely

Gareth Waterson

Corporate Director of Enterprise and Sustainable Regeneration

# ENTERPRISE AND SUSTAINABLE REGENERATION

**Corporate Director:** Gareth O Waterson BAcc CA  
Council Offices, Kirkwall, Orkney, KW15 1NY

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Website: [www.orkney.gov.uk](http://www.orkney.gov.uk)



Gillian Woolman, Audit Director  
Audit Scotland  
4th Floor  
102 West Port  
Edinburgh  
EH3 9DN

Dear Gillian

## Orkney Islands Council Pension Fund Annual report and accounts 2021/22

1. This representation letter is provided about your audit of the annual accounts of Orkney Islands Council Pension Fund for the year ended 31 March 2022 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the financial reporting framework, and for expressing other opinions on the remuneration report, management commentary and annual governance statement.
2. I confirm to the best of my knowledge and belief and having made appropriate enquiries as I consider necessary, the following representations given to you in connection with your audit of Orkney Islands Council Pension Fund annual accounts for the year ended 31 March 2022.

### General

3. Orkney Islands Council Pension Fund and I have fulfilled our statutory responsibilities for the preparation of the 2021/22 annual accounts. All the accounting records, documentation and other matters which I am aware are relevant to the preparation of the annual accounts have been made available to you for the purposes of your audit. All transactions undertaken by Orkney Islands Council Pension Fund have been recorded in the accounting records and are properly reflected in the financial statements.
4. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those reported by you.

### Financial Reporting Framework

5. The annual accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 (2021/22 accounting code), and in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003 and The Local Authority Accounts (Scotland) Regulations 2014.
6. In accordance with the 2014 regulations, I have ensured that the financial statements give a true and fair view of the financial position of the Orkney Islands Council Pension Fund at 31 March 2022 and the transactions for 2021/22.

## **Accounting Policies and Estimates**

7. All significant accounting policies applied are as shown in the notes to the financial statements. The accounting policies are determined by the 2021/22 accounting code where applicable. Where the code does not specifically apply I have used judgement in developing and applying an accounting policy that results in information that is relevant and reliable. All accounting policies applied are appropriate to Orkney Islands Council Pension Fund circumstances and have been consistently applied.

8. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. Judgements used in making estimates have been based on the latest available, reliable information. Estimates have been revised where there are changes in the circumstances on which the original estimate was based or as a result of new information or experience.

## **Going Concern Basis of Accounting**

9. I have assessed Orkney Islands Council Pension Fund's ability to continue to use the going concern basis of accounting and have concluded that it is appropriate. I am not aware of any material uncertainties that may cast significant doubt on Orkney Islands Council Pension Fund's ability to continue as a going concern.

## **Assets**

### **Investments**

10. For the year ended 31 March 2022, the amounts included in the net assets statements reflect investments managed/held both internally and externally by appointed fund managers and the global custodian on behalf of the funds. Amounts have been calculated in accordance with approved bases of valuation and fairly represent the values at 31 March 2022. In making these assertions I am reliant on the opinions of the appointed fund managers. As far as we can reasonably ascertain, all assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

### **Banking and Cash Flow Arrangements**

11. The pension funds maintain separate bank accounts and while these accounts form part of Orkney Islands Councils treasury management arrangements, the pension fund can demonstrate that there is no borrowing from the administering authority. Amounts due to the administering authority to cover daily cash flows such as payments through the council's systems are reimbursed on a regular basis.

### **Other Current Assets**

12. On realisation in the ordinary course of the funds' business, the other current assets in the Net Assets Statements are expected, in my opinion, to produce at least the amounts at which they are stated. In particular adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

### **Liabilities**

13. All liabilities at 31 March 2022 of which I am aware have been recognised in the annual accounts.

14. Provisions have been recognised in the financial statements for all liabilities of uncertain timing or amount at 31 March 2022 of which I am aware where the conditions specified in the 2021/22 accounting code have been met. The amount recognised as a provision is the best estimate of the expenditure likely to be required to settle the obligation at 31 March 2022. Where the effect of the time value of money is material, the amount of the provision has been discounted to the present value of the expected payments.



**15.** Provisions recognised in previous years have been reviewed and adjusted, where appropriate, to reflect the best estimate at 31 March 2022 or to reflect material changes in the assumptions underlying the calculations of the cash flows.

**16.** The pension assumptions made by the actuary in the IAS 26 report for Orkney Islands Council Pension Fund have been considered and I confirm that they are consistent with management's own view.

**17.** There are no plans or intentions that are likely to affect the carrying value or classification of the liabilities recognised in the financial statements.

### **Contingent liabilities**

**18.** There are no significant contingent liabilities, other than those disclosed in Note 31 to the financial statements, arising either under formal agreement or through formal undertakings requiring disclosure in the accounts. All known contingent liabilities have been fully and properly disclosed, including any outstanding legal claims which have not been provided under the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 and IAS 37.

### **Fraud**

**19.** I have provided you with all information in relation to:

- my assessment of the risk that the financial statements may be materially misstated because of fraud
- any allegations of fraud or suspected fraud affecting the financial statements
- fraud or suspected fraud that I am aware of involving management, employees who have a significant role in internal control, or others that could have a material effect on the financial statements.

### **Laws and Regulations**

**20.** I have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

### **Related Party Transactions**

**21.** All material transactions with related parties have been appropriately accounted for and disclosed in the financial statements in accordance with the 2021/22 accounting code. I have made available to you the identity of all the Orkney Islands Council Pension Fund's related parties and all the related party relationships and transactions of which I am aware.

### **Management commentary**

**22.** I confirm that the Management Commentary has been prepared in accordance with the statutory guidance and the information is consistent with the financial statements.

### **Corporate Governance**

**23.** I confirm that the Orkney Islands Council Pension Fund has undertaken a review of the system of internal control during 2021/22 to establish the extent to which it complies with proper practices set out in the Delivering Good Governance in Local Government: Framework 2016. I have disclosed to you all deficiencies in internal control identified from this review or of which I am otherwise aware.

**24.** I confirm that the Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government: Framework 2016 and the information is

consistent with the financial statements. There have been no changes in the corporate governance arrangements or issues identified, since 31 March 2022, which require to be reflected.

### **Events Subsequent to the Date of the Balance Sheet**

**25.** All events subsequent to 31 March 2022 for which the 2021/22 accounting code requires adjustment or disclosure have been adjusted or disclosed.

Yours sincerely

Gareth Waterson  
Corporate Director of Enterprise and Sustainable Regeneration

# Orkney Islands Council Pension Fund

2021/22 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Orkney Islands Council Pension Fund Sub-Committee and the  
Controller of Audit

November 2022

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# Key messages

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## 2021/22 annual report and accounts

- 1 Our audit opinions on the annual report and accounts are unmodified.
- 2 The financial statements of Orkney Islands Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

## Financial management

- 3 The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.
- 4 The Fund has returned an investment loss of 3% against a positive target of 9.6%.

## Financial sustainability

- 5 Fund performance levels in 2021/22 were below target and the value of the fund fell, however, the Fund still has sufficient assets to cover its liabilities.
- 6 The Fund reviewed its investment strategy following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

## Governance and transparency

- 7 Governance arrangements have been appropriate and operated effectively.
- 8 There is effective scrutiny, challenge and informed decision-making by committee.

## Best Value

- 9 The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management costs.
- 10 Although the value of investments fell in 2021/22, the longer term increase in the value of net assets is the largest across Scottish pension funds.

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# Introduction

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1. This report is a summary of our findings arising from the 2021/22 audit of Orkney Islands Council Pension Fund (the Fund).
2. The scope of our audit was set out in our Annual Audit Plan presented to the June 2022 meeting of the Pension Fund Sub-Committee. This report comprises:
  - an audit of the Fund's annual report and accounts
  - consideration of the wider dimensions of financial management, financial sustainability, governance and transparency, and value for money, that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. The main elements of our audit work in 2021/22 have been:
  - an audit of the Fund's 2021/22 annual report and accounts including the issue of an independent auditor's report setting out our opinions
  - a review of the Fund's main financial systems
  - consideration of the four audit dimensions of financial management, financial sustainability, governance and transparency and value for money.

## Added Value

4. We add value to the Fund through the audit by:
  - identifying and providing insight on significant risks, and making clear and relevant recommendations
  - sharing intelligence and good practice through our national reports ([Appendix 2](#)) and good practice guides
  - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Responsibilities and reporting

5. Orkney Islands Council is the administering authority for the Orkney Islands Council Pension Fund. The Council delegates this responsibility to the Pension Fund Sub-Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective.

The Pension Fund Sub-Committee is required to review the effectiveness of internal control arrangements and approve the annual report and accounts.

**6.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice 2016](#), and supplementary guidance, and International Standards on Auditing in the UK.

**7.** As public sector auditors we give independent opinions on the annual accounts. Additionally, we also conclude on:

- the effectiveness of the Fund's performance management arrangements
- suitability and effectiveness of corporate governance arrangements and financial position
- arrangements for securing financial sustainability.

**8.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**9.** This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**10.** Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## Auditor Independence

**11.** Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**12.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2021/22 audit fee of £22,090 as set out in our Annual Audit Plan remains unchanged.

**13.** This report is addressed to both the members of the Pension Fund Sub-Committee and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

## Audit appointment from 2022/23

**14.** The Accounts Commission is responsible for the appointment of external auditors to local government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The financial year 2021/22 was a one year extension and is the last year of the current appointment round

**15.** The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23 KPMG will be the appointed auditor for Orkney Islands Council Pension Fund. We are working closely with the new auditors to ensure a well-managed transition.

**16.** A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016. There are several significant changes introduced by the new Code, namely the integration of Best Value work into the wider scope audit work.

## Acknowledgements

**17.** We would like to thank Orkney Islands Council Pension Fund Sub-Committee and Board members and other staff for their co-operation and assistance over the last six years.



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# 1. Audit of 2021/22 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

Our audit opinions on the annual report and accounts are unmodified.

The financial statements of Orkney Islands Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

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## Our audit opinions on the annual report and accounts are unmodified

**18.** The annual report and accounts for the year ended 31 March 2022 were approved by the Orkney Islands Council Pension Fund Sub-Committee on 16 November 2022. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared in accordance with the guidance.

## The Covid-19 pandemic had minimal impact on our audit work

**19.** The unaudited annual report and accounts were received in line with our agreed audit timetable on 30 June 2022. As in the previous two years the audit was conducted remotely, observing social distancing measures.

**20.** The completeness and accuracy of accounting records and the extent of the information and explanations that were required for our audit were not affected by the Covid-19 outbreak.

**21.** The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit. This helped ensure that the audit of the annual accounts process ran smoothly.

## There were no objections raised to the annual report and accounts

**22.** The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts.

**23.** Regulation 9 requires a local authority to give public notice on its website by 17 June of the right to inspect its annual report and accounts. The date for inspection should be 14 days after the publication of the notice but cannot be later than 1 July and the inspection should last for 15 working days from the date specified in the notice.

**24.** As part of our audit, we identified that the inspection notice was not published until 27 June 2022 and therefore was outwith the timescales required by the regulations.

**25.** No objections were raised in relation to the 2021/22 annual report and accounts.

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## Recommendation 1

Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014

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## Overall materiality was revised on receipt of the unaudited annual report and accounts to £5.1 million

**26.** We apply the concept of materiality in both planning and performing the audit. The determination of materiality is based on professional judgement and is informed by our understanding of the entity and what users are likely to be most concerned about in the annual accounts.

**27.** We identify a benchmark on which to base overall materiality, such as net assets, and apply what we judge to be the most appropriate percentage level for calculating materiality values. In assessing performance materiality, we have considered factors such as our findings from previous audits, any changes in business processes and the entity's control environment including fraud risks.

**28.** We use materiality to evaluate the effect of identified misstatements and uncorrected misstatements on the audit and financial statements and when forming the opinion in the auditor's report.

**29.** Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

**30.** The revised materiality levels did not require a change in our audit approach as it did not change the assessment of material account areas.

## Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£5.1 million
Performance materiality	£3.8 million
Reporting threshold	£130 thousand
Specific materiality (applied to benefits expenditure and contributions income in the fund account)	£1 million
Specific performance materiality	£0.75 million

Source: Audit Scotland

## Significant findings to report on the annual report and accounts

**31.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have no issues to report from the audit.

**32.** We identified some disclosure and presentational matters which required amendment during our audit which have been reflected in the final set of accounts.

## We have obtained audit assurances over the significant financial statements' risks as identified in our 2021/22 Annual Audit Plan

**33.** We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. [Exhibit 2](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan audit. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

**Exhibit 2****Significant risks of material misstatement in the financial statements**

Audit risk	Assurance procedure	Results and conclusions
<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>	<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>• Substantively test income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</li> <li>• Undertake focussed testing of accounting accruals and prepayments.</li> </ul>	<p>We have not identified any indication of management override in the year leading to material misstatement or significant concern.</p> <p>We have reviewed the board's accounting records and obtained assurance that there were no transactions outside normal business processes.</p> <p>We have also reviewed management estimates and the journal entries posted in the period and around the year end. We did not identify any areas of bias in key judgements made by management.</p>

**Other areas of audit focus**

**34.** We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks.

35. We kept these areas under review throughout our audit based on the findings of the audit procedures performed. The results of our audit procedures and conclusions are set out in [Exhibit 3](#).

### Exhibit 3

#### Other areas of audit focus

Audit risk	Results and conclusions
<p><b>Actuarial valuation of future retirement benefits</b></p> <p>Actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary and review actuarial assumptions, and consider the report by Audit Scotland's consulting actuary on the actuarial valuations</p>	<p>We are satisfied that the retirement benefit obligation is correctly disclosed in the notes to the accounts in line with International Accounting Standard (IAS) 26 Accounting and Reporting by Retirement Benefit Plans.</p> <p>We use an auditor's expert to inform our review of the assumptions used in calculating this estimate and management's judgements. We concluded the assumptions are appropriate and within a range which we consider to be acceptable with assumptions towards the middle of the benchmarked range.</p>
<p><b>Valuation of unquoted investments</b></p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, and confirm valuations to valuation reports and/ or other supporting documentation for significant unquoted investments.</p>	<p>We gained appropriate assurance over the competency, capability and objectivity of fund managers.</p> <p>Each year, the pension fund receives internal control reports on their investment managers, and the custodian. These are high-level reports under International Standard on Assurance Engagements (ISAE3402), to provide assurance to user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting.</p> <p>The controls in place at fund managers are a key source of assurance over the investment values provided to the Fund and recorded in the annual report and accounts. In line with good practice the finding from the internal control reports should be presented to the Pension Fund Sub-Committee as part of the governance assurance framework.</p> <p><b>Recommendation 2</b></p> <p>(Refer <a href="#">Appendix 1</a>, action plan)</p> <p>The valuations were agreed to valuation reports provided by the custodian and the fund managers. The custodian holds the Fund's securities for</p>

Audit risk	Results and conclusions
	<p>safekeeping in order to minimise the risk of their misappropriation, misuse, theft and loss.</p> <p>The custodian only covers investments held by one of four fund managers. Three of the fund managers have been appointed over the last three financial years as a result of the change in the investment strategy. The Fund should consider expanding the use of the custodian to cover all fund managers in line with best practice.</p> <p><b>Recommendation 3</b></p> <p>(Refer <a href="#">Appendix 1</a>, action plan)</p>

## Identified misstatements of £10 million were adjusted in the accounts

**36.** Total misstatements identified were £10 million in relation to the understatement of purchases and sales of investments in year. The adjustment did not impact the net loss on investments or the net assets held by the fund at the year-end. Note 13 to the accounts outlines the in-year transactions and was adjusted to reflect the increased level of purchases and sales which took place in 2021/22.

**37.** We have reviewed the nature and causes of these misstatements and have concluded that they arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error.

**38.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. Management have adjusted all identified misstatements above our reporting threshold and there are no unadjusted errors to report.

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## 2. Financial management

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

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### Main judgements

Fund performance levels in 2021/22 were below target and the value of the fund fell, however, the Fund still has sufficient assets to cover its liabilities.

The Fund reviewed its investment strategy following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

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### The annual performance of the Fund was significantly impacted by Covid-19 and other world events

**39.** When considering the investment performance of the Fund during 2021/22, it is important to recognise the impact of Covid-19 and other world events on financial markets and investments. The global impact of the pandemic and the conflict in Ukraine has significantly increased market volatility. The Fund's performance in 2021/22 is summarised in [Exhibit 5](#).

**40.** The Fund has faced a challenging year in 2021/22. The net assets of the Fund, decreased from £520.8 million at 31 March 2021 to £508.5 million at 31 March 2022, after reaching a peak of £561.3 million in December 2021, the invasion of Ukraine cited as of significant impact. Consequently the Fund had a negative performance of 3%, against a benchmark of 9.6%.

**41.** Over recent years the fund has diversified investments, however, over 80% of the Fund's investments remain within growth assets which are generally more volatile.

## Exhibit 5

### Assets, funding level and investment performance

Decrease in net assets	Funding level	Estimated Past Service Liabilities	Investment performance
<b>£508.5 million</b>	<b>137%</b>	<b>£375 million</b>	<b>-3.0%</b>
Closing net assets as at 31 March 2022 (-2.36%)	Net assets vs promised retirement benefits 31 March 2022	Closing liabilities as at 31 March 2022 (4%)	Return on investments 2021/22
<b>£520.8 million</b>	<b>146%</b>	<b>£355 million</b>	<b>8.2%</b>
Opening net assets at 1 April 2021	Net assets vs promised retirement benefits 31 March 2021	Opening liabilities as at 1 April 2021	Average annual return on investments over 5 years

Source: 2021/22 Orkney Islands Council Pension Fund unaudited annual report and accounts

**42.** Hymans Robertson estimated the pension liabilities increased by 4% to £375 million at 31 March 2022 (2020/21 – £355 million). This estimate uses assumptions in line with International Accounting Standard (IAS) 26 requirements, for the purposes of the Fund’s financial statements.

**43.** The funding level takes into consideration the level of assets held by the Fund and the liability estimated at the year-end. The reduction in asset value combined with the increase in estimated liabilities has resulted in a 9 per cent drop in the funding level from 146 per cent to 137 per cent over 2021/22.

### The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance

**44.** The financial regulations of the Council, as administering authority, apply to the Fund. We consider these to be comprehensive, and current, and promote good financial management.

**45.** Investment and administration performance reports are submitted to the Pension Fund Sub-Committee on a quarterly basis. Reports are comprehensive, covering analysis of fund managers, review of asset allocation and a review of the markets. Also, through our attendance at the Pension Fund Sub-Committee, we have observed a good level of review and scrutiny by members.

**46.** Overall, the Fund has appropriate and effective financial management arrangements in place. This includes comprehensive reporting of investment performance.



## Financial systems of internal control operated effectively

**47.** As part of our audit, we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**48.** Our work in 2021/22 covered the key controls over the systems used for pension administration activity and the pension fund's investments. The Fund also uses the financial systems of the administering authority, Orkney Islands Council. The main council systems used by the Fund are the general ledger system and the payroll system. Our review of the controls in operation within these systems was conducted as part of our audit of Orkney Islands Council.

**49.** Our review of the systems used by the Fund and the administering authority did not identify any significant control weaknesses which could affect the Fund's ability to report financial and other relevant data in the financial statements, and we concluded that systems of internal control for the Fund operated effectively during 2021/22.

## Standards of conduct and arrangements for prevention and detection of fraud and error were appropriate

**50.** The Fund is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption. Furthermore, it is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

**51.** The risk profile of public bodies during 2021/22 has been significantly affected by the Covid-19 pandemic. This is likely to have increased the risk of fraud and error as control environments and internal controls have had to change to allow for services to operate effectively and respond to issues in a timely manner.

**52.** The Fund relies on the Council's arrangements for the prevention and detection of fraud and corruption. We have reviewed the arrangements put in place by the Council to address any heightened risks and concluded that there are appropriate arrangements for the prevention and detection of fraud, error and irregularities.

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# 3. Financial sustainability

Financial sustainability looks forward to the medium and long term to consider whether the Fund maintains the capacity to meet the current and future needs of its members.

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## Main judgements

Although the value of the fund fell in 2021/22, the Fund still has sufficient assets to cover its liabilities

The Fund reviewed its investment strategy following the triennial valuation and will continue to diversify the investment structure to support income generation.

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## We have no concerns over the financial sustainability of the fund or the viability of its funding strategy

**53.** The results of the 2020 full triennial valuation of the Orkney Islands Council Pension Fund showed a funding level of 118%, an improvement over the 2017 level of 112.7%. This meant that, overall, the Fund had a surplus of assets over liabilities and that the fund assets were sufficient to meet 118% of its liabilities.

**54.** The Fund obtains an interim valuation from the actuary which uses the same base as the triennial funding valuation, rolled forward to take account of changes in membership and updated assumptions.

**55.** The Fund has faced a challenging year in 2021/22 in terms of investment performance, with a significant fall in value of investments in the final quarter. The funding level decreased by 9% from 146% in 2021/22, however, the significant rise in the value of the fund in 2020/21 means that the fund has still increased since the triennial valuation.

## Medium term financial planning arrangements are appropriate and effective

**56.** There is considerable volatility in pension funding and the results of the triennial valuation are in effect a snapshot of the Fund at 31 March 2020. Following each triennial valuation, the Fund reviews and revises its funding strategy. The funding strategy is a summary of the Fund's approach to funding liabilities. The investment strategy outlines the types of investment to be held and the balances between the different types of investment.

**57.** The last review was carried out in 2021 after the results of the triennial valuation. The revised investment strategy reflects the Fund's decision to focus on income generation to build capacity to fund annual benefits

should they move to a net withdrawals position. The investment strategy therefore reflects a continued divestment in equities.

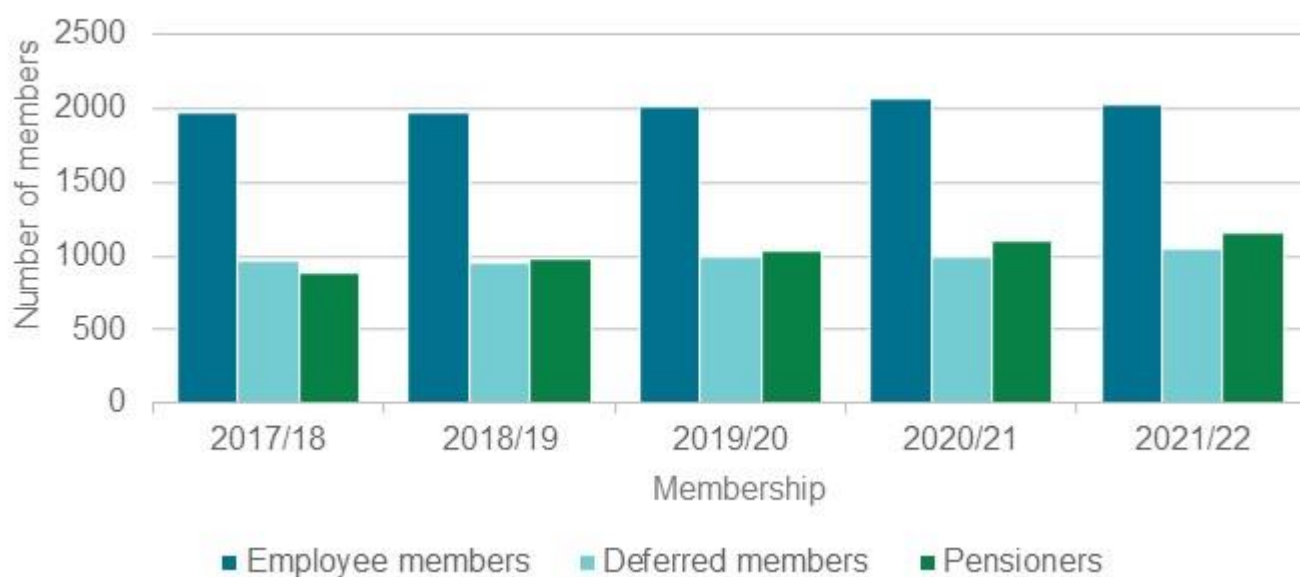
### Fund membership levels continue to increase but the ratio of active members to pensioners is reducing

**58.** The Fund is a multi-employer fund with four admitted bodies in addition to members employed by Orkney Islands Council. The current membership profile is shown at [Exhibit 6](#). The number of active members continues to outweigh the number of pensioners.

**59.** The Fund gives its members a guarantee that in exchange for contributions during their employment, it will pay a pension until the end of each member's life. It is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

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#### Exhibit 6 Orkney Islands Council Pension Fund Membership



Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

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**60.** Membership of the fund increased by 172 to 4,339 members at 31 March 2022; an increase in membership of 4%. The impact of auto-enrolment continues to contribute to the increase in employee members.

**61.** In 2021/22 the number of pensioners receiving a pension from Orkney Islands Council Pension Fund increased by 58 and the number of pensioner members continues to increase steadily each year. The number of active members continues to outweigh the number of pensioners but the ratio of active members to pensioners has reduced over the past five years.

## Future rates of employer contributions have remained stable

**62.** Following the triennial valuation in 2020, the actuary agreed employer contribution rates with individual employers from 1 April 2021 until 31 March 2024. For all member bodies the employer rate has remained at 17%. The approximate split of all contributions received in year is set out at [Exhibit 7](#).

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### Exhibit 7 Contributions in 2021/22

	Orkney Islands Council £m	Admitted bodies £m	Total £m
Employer contributions	7.22	0.85	8.07
Employee contributions	2.59	0.33	2.92
Strain contributions	0.11	0	0.11

Source: Orkney Islands Council Fund 2021/22 unaudited financial statements

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**63.** Cash flows received from dealings with members continue to be positive as the contributions received in year exceed the amount paid out in benefits

**64.** The majority of Scottish Local Government Pension Schemes pay out more in pension benefits than they receive in pension contributions. The Fund is not yet in this position. This demonstrates a relatively good position in terms of financial sustainability as the Fund is not reliant on investment income to support annual payments to pensioners.

**65.** Nevertheless, the continued growth in pensioner numbers within the Fund's membership makes funding pension payments increasingly challenging. The Fund has considered this as part of its investment strategy and is further diversifying its investment structure to increase investment in income generating assets.

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# 4. Governance and transparency

The effectiveness of scrutiny and oversight and the transparent reporting of information

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## Main judgements

Governance arrangements have been appropriate and operated effectively.

There is effective scrutiny, challenge and informed decision-making by committee.

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### **Governance arrangements are appropriate and operate effectively**

**66.** The Pension Fund Sub-Committee has been delegated responsibility for governance of the Fund by Orkney Islands Council, the administering authority.

**67.** The Pension Fund Sub-Committee is supported by a Pension Board in compliance with regulations and the requirements of the Pensions Regulator.

**68.** Following the local government elections in May 2022 a new Sub-Committee was appointed. This included 3 councillors who served on the Sub-Committee during 2021/22 and 4 councillors who were newly appointed to the sub-committee. The Pension Board also appointed 2 new members.

**69.** Due to the specialised nature of the Fund, it is vital that members have appropriate knowledge and understanding to provide appropriate challenge and scrutiny. Members are required to carry out appropriate levels of training to ensure they can perform their required duties.

**70.** A formal induction programme was delivered in June 2022 for all new members of the Council and included a presentation from the actuary covering the investment strategy and fund managers.

**71.** The Fund prepares an annual training plan which covers training, including The Pensions Regulator Trustee Toolkit training, and other essential training that will assist members in discharging their fiduciary duty.

### **There are effective arrangements for complying with The Pensions Regulator Public Service Code**

**72.** The Public Sector Pensions Act 2013 provided for extended regulatory oversight by The Pensions Regulator. The Pensions Regulator issued a code

on the governance and administration of public service pension schemes in January 2015 which funds are expected to comply with.

**73.** The Fund conducts a compliance review against the code on a regular basis and reports annually as part of the Annual Accounts through the Governance Compliance Statement. This provides assurance that the Fund is in compliance with the regulations.

**74.** There were no breaches of the code that required to be reported to The Pensions Regulator in 2021/22. In 2019/20 we identified that the Fund did not maintain a breaches register which heightens the risk that systematic issues are not identified by management. We are pleased that this was implemented during 2021/22 ([Appendix 1](#)).

### **Performance reporting was of a good standard**

**75.** Management Commentaries included in the annual accounts should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**76.** The Fund's 2021/22 management commentary is of good quality and is written with the stakeholder in mind. It presents some complex areas in an understandable style which increases transparency in reporting the financial performance and financial position.

# 5. Best Value

Using resources effectively and continually improving services

## Main judgements

The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management costs.

Although the value of investments fell in 2021/22, the longer term increase in the value of net assets is the largest across Scottish pension funds.

## The pension administration function has performed well against targets

**77.** The Pension Fund Sub-Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance. The focus of measuring the performance of pensions administration includes both member experience and statutory compliance. Performance of the administration of the fund is summarised in [Exhibit 8](#) below.

**78.** Service levels were maintained in the majority of areas; however, they did fall in processing refunds and pension estimates as a result of additional pressure on staff due to Covid-19. It should be noted that the relatively small size of the fund and transactions involved mean that even small numbers of records not being processed can make significant percentage differences.

### Exhibit 8

#### Administration Performance

	Performance Standard (days)	Percentage processed within standard 2020/21	Percentage processed within standard 2021/22	Relative performance compared to prior year
Pension estimates	10	92.8%	96.8%	↑
Retirements	5	100.0%	100.0%	→
Transfers in	10	100.0%	94.4%	↓

Transfers Out	10	100.0%	100.0%	➔
Refunds	5	94.1%	84.6%	⬇
New Entrant Information	10	100%	100%	➔
Leaver Information	10	100%	100%	➔
Deferred Benefit Information	1 Month	95.4%	100%	⬆

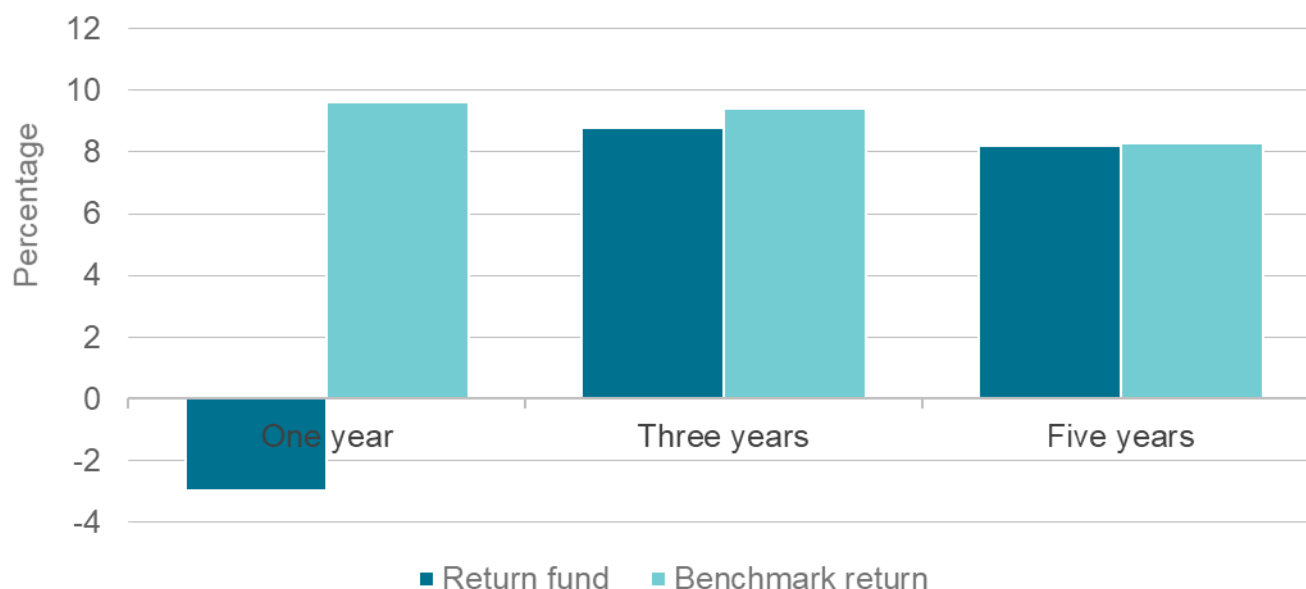
Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

## The continuing impact of Covid-19 and the conflict in Ukraine on global markets reduced annual returns

**79.** The Fund appoints four external investment managers. Individual investment manager performance is reviewed regularly by the Pension Fund Sub-Committee.

**80.** [Exhibit 9](#) shows that the Fund generated a return of -3% against a benchmark of 9.6%.

### Exhibit 9 Fund investment performance



Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

**81.** Financial markets have been exceptionally volatile in recent years due to the ongoing Covid-19 pandemic and more recently as result of the conflict in



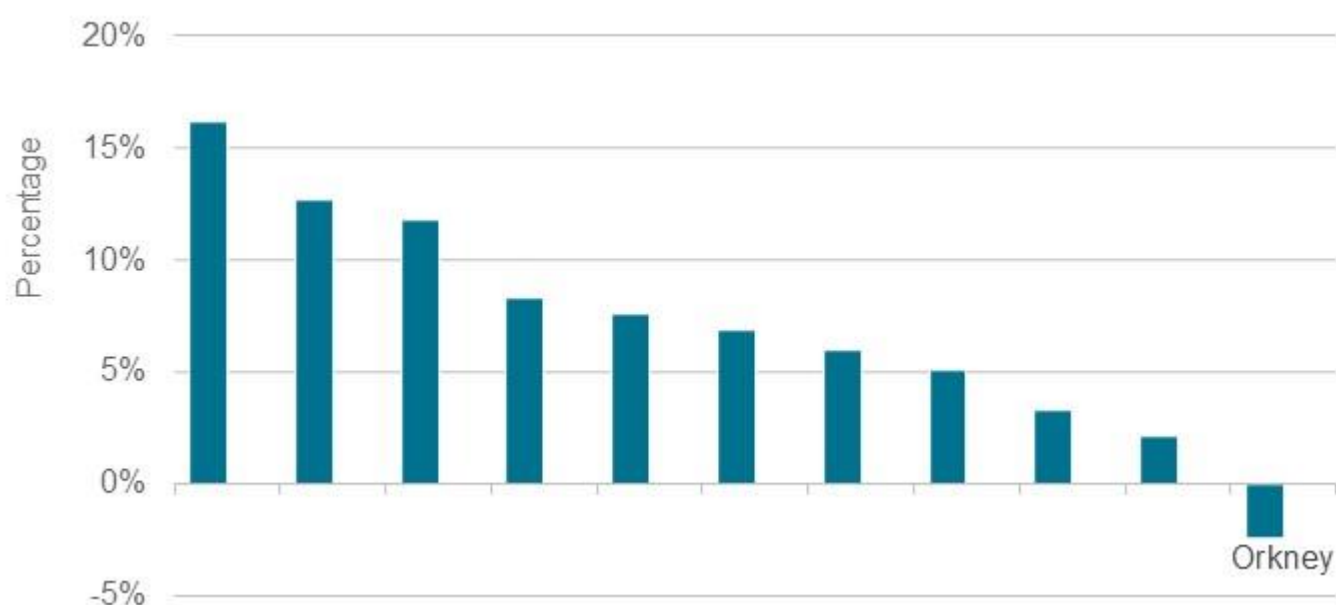
Ukraine. Returns against most asset classes, especially equities reduced significantly in the final quarter of 2021/22. Approximately 60% of the Fund's investment portfolio is made up of equities and this is a significant contributor to the decrease.

**82.** The negative investment return is the lowest across Scotland, as can be seen in [Exhibit 10](#) below, however, when reviewing the Fund's performance, it is important to consider the longer term. The Fund was marginally behind the three and five year benchmarks with the weaker performance in the current year being offset by strong performance in previous years.

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### Exhibit 10

#### Fund investment performance across Scotland 2021/22



Source: Unaudited annual accounts for Scottish pension funds 2021/22

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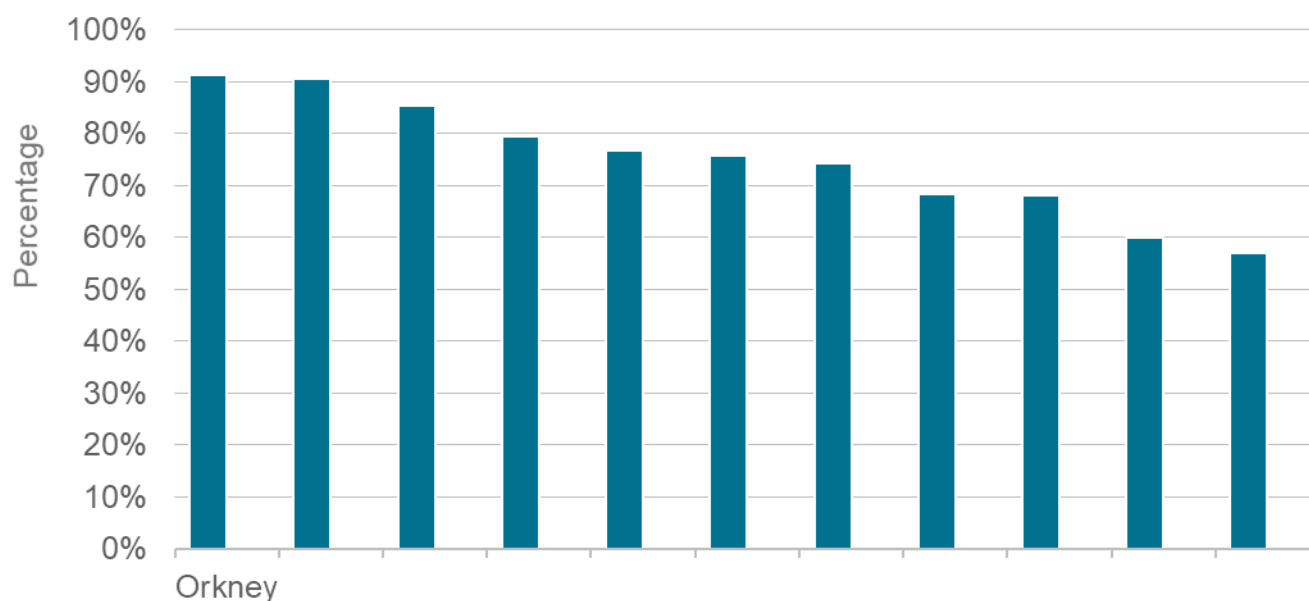
**83.** The Fund has over 80% of funds invested in growth assets which were impacted adversely by the market volatility in 2021/22. We have considered the longer term trends in [Exhibit 11](#) which shows the change in the value of funds since April 2016.

**84.** The change in value includes the return on investments, the impact of transfers in and out the fund and the net contributions from dealings with members.

**85.** Over the six year period the value of Orkney has the largest increase in value across Scotland.

## Exhibit 11

### Change in value of funds since 1 April 2016



Source: Unaudited annual accounts for Scottish pension funds 2021/22

## The Fund scrutinises investment management expenses appropriately

**86.** There are three main categories of management expense, with the largest being investment management costs. Other expenses are the cost of the administration services provided by the Council and oversight and governance costs.

**87.** Investment management expenses have increased from £1.905 million in 2020/21 to £2.231 million in 2021/22. Investment manager expenses can vary due to a number of factors including actual return on investments and the nature of investments held. Although overall asset values dropped in year, until December 2021 there was strong asset performance which would have resulted in high management fees.

**88.** The Fund has also diversified its portfolio and employs an additional fund manager which will have increased costs.

**89.** The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

## National performance audit reports

**90.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2021/22, we published reports which may be of interest to the Fund. These are outlined in [Appendix 2](#) accompanying this report.

# Appendix 1

## Action plan 2021/22

### 2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Advertising the Financial Statements</b></p> <p>The financial statements were not advertised in accordance with the Local Authority Accounts (Scotland) Regulations 2014.</p> <p>Risk – there is a risk that the public does not have the ability to inspect and object to the accounts as appropriate.</p>	<p>Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014</p> <p><a href="#">Paragraph 24.</a></p>	<p>Agreed, we have updated our accounts closure timetable to include this date and ensure it is met going forward.</p> <p>Service Manager (Corporate Finance)</p> <p>Completed</p>
<p><b>2. ISAE3402 Control Reports</b></p> <p>Each year, the pension fund receives internal control reports on their investment managers and the custodian. These are high-level reviews developed under International Standard on Assurance Engagements (ISAE3402), to provide assurance to user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting.</p> <p>Risk – there is a risk that members are not aware of issues identified at the fund managers.</p>	<p>To enhance performance management reporting, details of the investment manager internal control reports should be provided to members of the pension fund sub-committee along with any observations raised by management.</p> <p><a href="#">Paragraph 35.</a></p>	<p>Agreed, details of investment manager internal control reports will be provided to members of the pension fund sub-committee along with any observations raised by management going forward.</p> <p>Senior Manager (Corporate Finance)</p> <p>November 2022</p>

Issue/risk	Recommendation	Agreed management action/timing
<p><b>3. The Custodian</b></p> <p>The custodian covers investments held by only one of four fund managers. The custodian holds the Fund's securities for safekeeping in order to minimise the risk of their misappropriation, misuse, theft and loss.</p> <p>Risk – there is an increasing proportion of the Fund's assets which are not covered by custodian safeguards.</p>	<p>Consideration should be given to expanding the use of the custodian to cover all fund managers.</p> <p><a href="#">Paragraph 35.</a></p>	<p>Agreed, a review of existing operations will include expanding the role of custodian.</p> <p>Senior Manager (Corporate Finance)</p> <p>March 2023</p>

## Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>4. Breaches register</b></p> <p>There is no register held by the Fund detailing the breaches of the Pensions Regulator Public Service Code in year.</p> <p>Risk</p> <p>There is a risk that an issue is not raised with management which requires to be reported</p>	<p>We recommend the Fund creates a register of all breaches to inform the decision over whether to report issues to the Pensions Regulator.</p>	<p><b>Complete</b></p> <p>The Register of Breaches has been created by the Pension and Payroll Manager.</p>
<p><b>5. Validation of fund manager valuations</b></p> <p>Barings provided a valuation of investments held at 31 March 2020. From our review of the document it was not possible to identify the Fund's share of assets. No work has been conducted by the Fund to validate the valuation provided by Barings.</p> <p>Risk</p>	<p>We recommend the Fund conducts work to assure themselves that asset valuations provided by the fund manager are reasonable and in line with expectation.</p>	<p><b>Complete</b></p> <p>We are satisfied that the Fund Manager uses an external valuer to provide additional advice over hard to value assets. We are aware that the Fund also takes assurance from the ISAE3402 reports from fund managers which covers the controls over the valuation process and we have made recommendations above to</p>

Issue/risk	Recommendation	Agreed management action/timing
There is a risk that a misstatement in the valuation is not noticed by the Fund on a timely basis.		improve the governance around this process.

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# Appendix 2

Summary of national performance reports 2021/22 and briefing papers

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## May

[Local government in Scotland Overview 2021](#)

## June

[Covid 19: Personal protective equipment](#)

## July

[Community justice: Sustainable alternatives to custody](#)

## September

[Covid 19: Vaccination programme](#)

## January

[Planning for skills](#)

[Social care briefing](#)

## February

[NHS in Scotland 2021](#)

## March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

# Orkney Islands Council Pension Fund

## 2021/22 Annual Audit Report

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

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