Item: 4

Pension Fund Sub-committee: 20 September 2023.

Pension Fund – Annual Accounts Audit – Update.

Report by Corporate Director for Enterprise and Sustainable Regeneration.

1. Purpose of Report

To present an update on audit progress in respect of the Annual Report and Accounts of the Orkney Islands Council Pension Fund for financial year 2022/23.

2. Recommendations

The Sub-committee is invited to note:

2.1.

The requirement, in terms of the Local Authority Accounts (Scotland) Regulations 2014, for a local authority, or a committee of the authority, whose remit includes audit or governance functions:

- To consider and approve the audited Annual Accounts for signature no later than 30 September immediately following the financial year to which the accounts relate.
- To publish the accounts on a website by 31 October.

2.2.

That, although the unaudited annual accounts were submitted to KPMG by the required deadline of 30 June 2023, as this is the first year of KPMG's 5-year appointment as the Council's external auditors and, given the pressures on the audit profession, together with changes to certain auditing standards, certain aspects of the audit are still ongoing and will not be completed in time to allow a full audit opinion to be reached before 30 September 2023.

2.3.

That Audit Scotland has been notified of the situation outlined above and have been in regular contact with KPMG and all other auditors to monitor progress with the 2022/23 audits, as they knew this year would prove challenging to meet the 30 September deadline.

2.4.

That the Annual Accounts, together with an appropriate audit certificate, will be considered by the Pension Fund Sub-committee, at its next meeting scheduled for 22 November 2023.

2.5.

The audit status update report from KPMG, attached as Appendix 1 to this report, updating members on matters arising from the audit work carried out to date, together with draft conclusions.

3. Background

3.1.

Orkney Islands Council acts as Administering Authority for the Orkney Islands Council Pension Fund.

3.2.

The Orkney Islands Council Pension Fund is constituted under the various Local Government Pension Funds Acts and related regulations and provides pension benefits to all local government employees, excluding principally teachers, together with six other organisations of a statutory or voluntary nature which have been accepted into the Pension Fund as admitted bodies.

3.3.

The purpose of the annual statement of accounts is to demonstrate proper stewardship of the Pension Fund’s financial affairs.

3.4.

On 31 August 2023, the Pension Fund Sub-committee approved the draft Annual Report and Accounts of the Pension Fund for financial year 2022/23 and the Annual Governance Statement, comprising pages 17 to 24 of the draft Annual Report and Accounts.

3.5.

Under the Local Authority Accounts (Scotland) Regulations 2014, a local authority, or a committee of the authority whose remit includes audit or governance functions, must meet to consider the audited Annual Accounts; and aim to approve those accounts for signature no later than 30 September immediately following the financial year to which the accounts relate. The committee must consider whether the Annual Accounts should be signed, having regard to any report made on the accounts and any advice given by the proper officer or the auditor.

4. External Audit Annual Plan – Update

4.1.

This is the first year of KPMG's 5-year appointment as the Council's auditors and given the pressures upon the audit profession, and changes to certain auditing standards, certain aspects of the audit are still ongoing and will not be completed in time to allow a full audit opinion to be reached before 30 September 2023. On enquiry with Audit Scotland, they confirmed that:

- "[They] have been in regular contact with KPMG and all auditors to monitor progress with the 22/23 audits. The local government target dates for completion have been moved forward from 31 October last year to 30 September this year, and with delays to completing many of last year's audits and the handover of auditors, we knew that this would be a challenging year for auditors. Based on our current information, we are expecting more than half of councils and a third of pension funds to be signed off after 30 September".
- "We have consistently emphasised that auditors should aim to deliver a high-quality audit, even if this results in them being unable to meet the target dates. We recognise that a delayed audit is an inconvenience to you as the preparer of the accounts and I am confident that KPMG are doing all they can to minimise the delay."

4.2.

Annual Accounts, together with an appropriate audit certificate, will be considered for approval at the Pension Fund Sub-committee on 22 November 2023.

4.3.

Appendix 1 to this report is an update from KPMG to on the work carried out to date and their draft conclusions so far.

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

6.1.

Existing staff resources are deployed as part of the annual financial year end closedown process to prepare the annual report and accounts for the Pension Fund.

6.2.

The audit fee payable to Audit Scotland for the audit work on the Pension Fund was £24,860 for financial year 2022/23 (compared to £22,090 for the previous year).

7. Legal Aspects

7.1.

Councils which are responsible for administering a pension fund (administering authorities), forming part of the Local Government Pension Scheme, are required by the Local Government Pension Scheme (Administration) (Scotland) Regulations 2018 to publish a Pension Fund Annual Report. The Pension Fund Annual Report includes the financial statements of the Pension Fund.

7.2.

Regulation 10 (1)(b) of the Local Authority Accounts (Scotland) Regulations 2014 states that the council must “aim to approve those accounts for signature as described in this regulation no later than 30th September immediately following the financial year to which the accounts relate”.

8. Contact Officers

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9. Appendix

Appendix 1: KPMG Annual Report and Accounts Audit Status Update - 15 September 2023.

Appendix 1

Orkney Islands Council Pension Fund

Draft Audit Status Update

For Pension Fund Sub Committee

Prepared on 15 September 2023

Purpose of the report and background

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Purpose

This report has been prepared to update members of the Pension Fund Sub Committee in connection with our audit of the financial statements of Orkney Islands Council Pension Fund, prepared in accordance with International Financial Reporting Standards ('IFRSs') as amended for the UK public sector, as at and for the year ended 31 March 2023.

This report summarises the **draft** conclusions and matters arising to date.

This report should be read in conjunction with our audit plan and strategy report, presented on 18 May 2023. There have been no significant changes to our audit plan and strategy.

Background

The Local Authority Accounts (Scotland) Regulations 2014 require a Local Authority, or a committee of that authority whose remit includes audit or governance functions to meet to consider the audited Annual Accounts and aim to approve those accounts by 30 September and subsequently publish by end October.

The Council planned to approve the Annual Accounts for the year ended 31 March 2023 for signature at this meeting however while significant audit progress has been made in a number of areas, including significant risk areas, there are aspects ongoing including important audit queries and areas of auditor challenge.

Continual enhancement of audit quality, changes in audit standards and expectations of the audit profession as a whole, together with the additional requirements of a first year audit, have contributed to the extended timeline being experienced across a number of local government and other audits.

We would like to acknowledge our thanks and appreciation for the engagement and support of Council officers in progressing the audit to date.

This report provides an update in respect of audit progress and does not represent final conclusions.

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Key contacts

Your key contacts in connection with this report are:

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Significant Risk	Description	Response and findings
Management override of control		
Significant risk over management override of controls	• Professional standards require us to communicate the fraud risk from management override of controls as significant. • Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. • As part of our planning procedures we have not identified any specific additional risks of management override relating to this audit.	Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we have evaluated the design and implementation of the controls in place for the approval of manual journals posted to the general ledger to ensure that they are appropriate. In regards to the financial reporting and journals process, we performed the following over journal entries and other adjustments: • We considered any high risk criteria underpinning specific journals to test substantively. Where journals met this criteria, we audited each journal individually. • Evaluated the completeness of the population of end of reporting journal entries. • Identified and tested items in the population of end of reporting journal entries based on our professional judgement. Work is ongoing over journals at this time, although no issues have been identified from our work to date

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Other Audit Risk	Description	Response and findings
Incorrect valuation of level 1, 2 and 3 investments		
Other audit risk over the valuation of level 1, 2 and 3 investments	The valuation for investments as 31 March 2023 is £479m, split as below: • Level 1: £290m (2022 £301m) • Level 2: £124m (2022 £158m) • Level 3: £65m (2022 £46m) Due to use of observable / unobservable inputs in the valuation of assets, there is an inherent risk of incorrect valuation of investments. Further, given different investment managers and the volume of transactions, there is a risk that material investments transactions are missed or made close to year end/ in the following year leading to recording in incorrect periods. It will result to an incorrect valuation of investments and change in market value amounts being recognised.	We confirmed our understanding of the processes and controls in relation to the recording of investment transactions by the Orkney Islands Council as the administering authority (OIC) in the financial statements. Our audit procedures included: • We obtained direct confirmations from all your investment managers and custodian to confirm the holdings and valuation of assets at the year end. • We gained an understanding of the control environment at all the investment managers and custodian by reviewing their internal controls reports to identify any control deficiencies that would impact our audit approach. • The Baillie Gifford investments (Level 1 and 2) were valued by iRADAR with no significant differences. • For the unit linked insurance policies with LGIM, there was no external pricing source. We obtained specific confirmation that the investment manager would transact at the price quoted as at that date, and checked that the fund manager was FCA registered. • We noted that the equity pooled fund of £1.2m is currently included in equities. This is a pooled fund and should be reclassified as a PIV. We propose to raise an audit adjustment to correct this disclosure misclassification

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Other Audit Risk	Description	Response and findings
Incorrect valuation of level 1, 2 and 3 investments (continued)		
Other audit risk over the valuation of level 1, 2 and 3 investments	The valuation for investments as 31 March 2023 is £479m, split as below: • Level 1: £290m (2022 £301m) • Level 2: £124m (2022 £158m) • Level 3: £65m (2022 £46m) Due to use of observable / unobservable inputs in the valuation of assets, there is an inherent risk of incorrect valuation of investments. Further, given different investment managers and the volume of transactions, there is a risk that material investments transactions are missed or made close to year end/ in the following year leading to recording in incorrect periods. It will result to an incorrect valuation of investments and change in market value amounts being recognised.	• For level 3 assets, we reconciled the closing unit holdings based on audited prior period position and purchases and sales transactions reported by the investment managers. • We reviewed the audit report to confirm that it is unqualified and that the audit has been carried out by a reputable audit firm; and • We compared the unaudited pricing information at the year end to the audited financial statements valuation. Where the audited financial statements are not as at the Fund year end date, we agreed them to unaudited pricing information at that date and reconcile material movements to the Fund year end date. • We obtained and reviewed the latest audited financial statements including checking that the audit was carried out by a recognised audit firm, whether there was a qualified audit opinion or any areas in relation to market uncertainty, whether they had been prepared under a recognised accounting framework and whether the investments are valued at fair value. No other matters to report at this time, but our work is ongoing.

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Other Audit Risk	Description	Response and findings
Inaccurate or late contributions		
Other audit risk over inaccurate or late contributions	Contributions are material to financial statements and includes both employer's contributions worth £8.7m (2022 £8.1m) and member's contributions worth £3.1m 2022 £2.9m). Total £11.9m (2022 £11.1m). Revenue in a pension fund equates to contributions receivable. Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. This revenue is recognised based on specific instructions as set out in the appropriate schedule(s). There are no subjective issues concerning when contributions need to be recognised. Amounts involved cannot easily be manipulated through accounting policies, issue of credit notes, timing or other policies. Therefore, in the absence of specific fraud risk factors, the presumption that fraudulent revenue recognition is a significant risk is rebutted for pension fund audits.	As part of our audit procedures, we gained an understanding of the processes over the contribution payment arrangements between the admitted bodies / schedule bodies and administrator and also the effectiveness of the local pension board’s contribution monitoring arrangements. Our audit procedures over contributions included: • Verified that all contributions were received into the Fund on a timely basis under the Schedule of Contributions and LGPS requirements. • Calculating an expectation of the normal employer and employee contributions receivable in the year reflecting changes in active members in the year, increases in pensionable salary and any changes in the contributions rates in the year; • Ensured that there were 12 months receipts in the year and assessing the trend of such receipts; • For a sample of members carried out re-performance checks on normal employee and employer contributions by reference to their pensionable salary and rates as stated in the LGPS requirements. No issues noted so far and our work is in progress in this respect as we await for responses to some queries related to membership statistics and other supporting information.

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Other Audit Risk	Description	Response and findings
Management of cash		
Other audit risk over misstatement of pension fund cash at bank	At pension fund, generally, all cash payments such as benefits payments, Investment management expenses and other expenses, Investment purchases and receipts as contribution, Investment sales, Investment income, other income in pension fund are processed via bank. Therefore, there is an inherent risk around misappropriation of cash.	Our audit procedures included: • Obtain the bank confirmation directly from the bank. • Compare audited entity balances with the bank reconciliation provided by the administrator and the bank confirmation received directly from the bank. • Obtain the bank reconciliation (where there are reconciling items) and test any significant reconciling items. No issues were noted.

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Other Audit Risk	Description	Response and findings
Change in market value and / or investment income misstated		
Other audit risk over change in market value and / or investment income	The valuation for investments as 31 March 2023 is £479m, split as below: • Level 1: £290m (2022 £301m) • Level 2: £124m (2022 £158m) • Level 3: £65m (2022 £46m) Due to use of observable / unobservable inputs in the valuation of assets, there is an inherent risk of incorrect valuation of investments. Further, given different investment managers and the volume of transactions, there is a risk that material investments transactions are missed or made close to year end/ in the following year leading to recording in incorrect periods. It will result to an incorrect valuation of investments and change in market value amounts being recognised.	Our audit procedures included: • Agreed sales and purchases per the investment reconciliation to investment manager/custody reports; • Agreed opening and closing investment balances to investment manager statements; • Agreed investment income to investment manager reports/ custodian reports and/or bank statements, where material; • Agreed cash received/paid through to the Fund accounting records; and • Agreed the overall investment return stated in the Annual report for consistency with the amounts reported in the financial statements. Our work is in progress in relation to confirming sales and purchases and agreeing investment income for all investments.

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Other Audit Risk	Description	Response and findings
Incorrect benefit payments		
Other audit risk over incorrect benefit payments	Benefits payable (includes regular pension paid, pensions paid to dependants, lumpsums and death grants) amounts to £10.3m (2022 £9.1m) Payments to and on account of leavers (includes individual / group transfers and contribution returned) amounts to £3.2m (£738k). Increase due to the Group Transfer for the Highlands and Islands Enterprise Orkney in the year.	Our audit procedures over pension payments included: • Calculating an expectation of the amounts payable in the year reflecting changes in pensioner numbers in the year and the annual pension increase applied; • Ensuring that there are monthly pension payments in the year and assessing the trend of such payments; Our audit procedures over benefit payments and transfers included: • Verifying the consistency of membership movements per the administrator database to payments made per the nominal ledger; • Review of after date payments to ensure no unrecorded liabilities and to ensure cut off is correct; No individual transfers out or benefit payments were material on an individual basis. No issues noted so far and our work is in progress in this respect, as we await for responses to some queries related to membership statistics and other supporting information. .

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Other Audit Risk	Description	Response and findings
Incorrect financial statement presentation		
Other audit risk over incorrect financial statement presentation	The financial statements are required to be prepared under Part VII of the Local Government (Scotland) Act 1973 and be the financial reporting framework be 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 2022/23 (the 2022/23 Code).	We have reviewed the Fund's draft annual report and financial statements and checked them against the disclosure requirements of CIPFA Code Disclosure checklist and our financial statement disclosure checklist, which takes account of the requirements of the Code of Practice. Below are our review findings: • Include a policy for benefits payable and taxation. Further, suggested to clarify the basis of recognition for investment income and contributions. • Include a note to make clear that the financial statements had been prepared on a going concern basis. • Update risk disclosures for indirect interest rate risk exposure on the bond funds and clarification on indirect vs direct risk on the investments. • Contractual commitments note to be updated to reflect the remaining capital commitment at the year end. • Contingent liability note to be updated to reflect the potential liability for GMP Equalisation for the Fund. At the present time, the impact has been noted in relation to the actuarial valuation only. • AVC valuation at the year end to be updated following receipt of information. • Reclassification of the equity fund We also noted a number of other minor presentation and typographical changes. No other matters to note at the time of writing this report.

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Other Audit Risk	Description	Response and findings
Incorrect financial statement presentation (continued)		
Other audit risk over incorrect financial statement presentation *Valuation of present value of promised retirement benefits*	The valuation of promised retirement benefits involves the selection of appropriate actuarial assumptions, most notably the discount rate applied to the fund liabilities, inflation rates and mortality rates. The selection of these assumptions is inherently subjective and small changes in the assumptions and estimates used to value the benefits could have a material impact. The effect of these matters is that, as part of our risk assessment, we determined that present value of promised retirement benefits as at 31 March 2023 has a high degree of estimation uncertainty. The liability as at 31 March 2023 is £324m (2022 £485m).	• We evaluated the capability, competency and objectivity of the Fund Actuary as an external expert. • We used our internal actuarial experts to inform our review of the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy against externally derived data. • We considered the disclosure in the financial statements to ensure it is appropriate No matters have arisen from our work to date, but our work is ongoing at the time of writing this report

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ("the auditing Code").

This report is for the benefit of Orkney Islands Council Pension Fund and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries").This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice. We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

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