Item: 4

Pension Fund Sub-committee: 22 November 2023.

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 KPMG, 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 2023.

2.2.

That KPMG has provided an unqualified certificate on the Pension Fund's Annual Report and Accounts for the year ended 31 March 2023.

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 disclosure misstatements and other minor presentation and typographical changes 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.

Orkney Island's Council's Letter of Representation to KPMG in connection with their audit of the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2023, attached as Appendix 1 to this report.

2.7.

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 2 to this report.

3. External Audit

3.1.

The main elements of the audit work carried out by KPMG for financial year 2022/23 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 2022/23 Code of the financial transactions of the fund during the year ended 31 March 2023 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 amended for the UK public sector.
    - 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 of risk, as follows:
    - Incorrect valuation of Levels 1, 2 and 3 investments.
    - Inaccurate or late contributions.
    - Misstatement of cash.
    - Change in market value and/or investment income misstated.
    - Incorrect benefit payments.
    - Incorrect financial statement presentation.
    - Going concern.
- A review of four areas of wider scope was also carried out to comply with the new Code of Audit Practice, as follows:
    - Financial management.
    - Financial sustainability
    - Vision, Leadership, and governance.

- Use of resources to improve outcomes.

3.2.

In addition to the four areas of wider scope detailed above, Audit Scotland also mandated that, for their National Risk Assessment, all bodies should be assessed for:

- Climate Change.
- Cyber Security.

4. External Audit Findings

4.1.

As part of the completion of the audit, KPMG 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 1 to this report.

4.2.

KPMG have reported that their independent auditor’s report, dated November 2023, contains an unqualified audit opinion on the Statement of Accounts for the Pension Fund for the year ended 31 March 2023. The independent auditor’s report, attached as Appendix 2 to this report, certifies that the accounts have been properly prepared in accordance with applicable law, accounting standards and other reporting requirements.

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 2 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 £24,860 which is £2,770 more than the fee for the 2021/22 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 pension 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.

Erik Knight, Head of Finance, extension 2127, Email erik.knight@orkney.gov.uk.

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

9. Appendices

Appendix 1: Orkney Islands Council’s Letter of Representation to KPMG in connection with their audit of the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2023.

Appendix 2: KPMG Annual Report to Members and the Controller of Audit of the Orkney Islands Council Pension Fund Annual Report and Accounts (ISA 260 Report).

Appendix 1

ENTERPRISE AND SUSTAINABLE REGENERATION

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

Tel: (01856) 873535 Website: www.orkney.gov.uk

ORKNEY ISLANDS COUNCIL

KPMG LLP
1 St Peter's Square
Manchester
M2 3AE

DATE

Dear Julie

This representation letter is provided in connection with your audit of the financial statements of Orkney Islands Council Pension Fund ("the Fund"), for the year ended 31 March 2023, for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the financial transactions of the Fund during the year ended 31 March 2023 and of the amount and disposition at that date of its assets and liabilities;
ii. whether the financial statements have been properly prepared in accordance with UK adopted international accounting standards, as interpreted, and adapted by the 2022/23 Code; and
iii. whether the financial statements 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.

These financial statements comprise the Pension Fund Account, the Net Assets Statement, and notes to the financial statements, including a summary of significant accounting policies.

I confirm that the representations I make in this letter are in accordance with the definitions set out in the Appendix to this letter.

I confirm that, to the best of my knowledge and belief, having made such inquiries as it is considered necessary for the purpose of appropriately informing myself:

Financial statements

1. I have fulfilled my responsibilities, as set out in the terms of the audit engagement letter dated 18 May 2022, for the preparation of financial statements that:

   i. give a true and fair view of the financial transactions of the Fund during the year ended 31 March 2023 and of the amount and disposition at that date of its assets and liabilities;
   ii. have been properly prepared in accordance with UK adopted international accounting standards, as interpreted, and adapted by the 2022/23 Code; and
   iii. 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.

   The financial statements have been prepared on a going concern basis.

2. The methods, the data and the significant assumptions used in making accounting estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework.

3. All events subsequent to the date of the financial statements and for which IAS 10 *Events after the reporting period* requires adjustment or disclosure have been adjusted or disclosed.

Information Provided

4. I have provided you with:

   - access to all information of which I am aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from myself for the purpose of the audit; and
   - unrestricted access to persons within the Fund from whom you determined it necessary to obtain audit evidence.

5. All transactions have been recorded in the accounting records and are reflected in the financial statements.

6. I confirm the following:

   i) I have disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

   Included in the Appendix to this letter are the definitions of fraud, including misstatements arising from fraudulent financial reporting and from misappropriation of assets.

   ii) I have disclosed to you all information in relation to:

   a) Fraud or suspected fraud that I am aware of and that affects the Fund and involves:
      - management;
      - employees who have significant roles in internal control; or
      - others where the fraud could have a material effect on the financial statements; and

   b) allegations of fraud, or suspected fraud, affecting the Fund's financial statements communicated by employees, former employees, analysts, regulators or others.

   In respect of the above, I acknowledge my responsibility for such internal control as I determine necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error, and I believe I have appropriately fulfilled those responsibilities.

7. 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 the financial statements.

8. I have disclosed to you and have appropriately accounted for and/or disclosed in the financial statements, in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

9. I have disclosed to you the identity of the Fund's related parties and all the related party relationships and transactions of which I am aware. All related party relationships and transactions have been appropriately accounted for and disclosed in accordance with IAS 24 *Related Party Disclosures.*

   Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as I understand them and as defined in IAS 24 and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2022/23.

10. I confirm that:

    a) The financial statements disclose all of the matters that are relevant to the Fund's ability to continue as a going concern, including the key risk factors, assumptions made and uncertainties surrounding the Fund's ability to continue as a going concern as required to provide a true and fair view and to comply with IAS 1 *Presentation of Financial Statements*.
    b) No material uncertainties related to events or conditions exist that may cast significant doubt upon the ability of the Fund to continue as a going concern.

11. On the basis of the process established by the Fund and having made appropriate enquiries, I am satisfied that the actuarial assumptions underlying the valuation of defined benefit obligations are consistent with my knowledge of the business and are in accordance with the requirements of IAS 26 *Accounting and Reporting by Retirement Benefit Plans.*

    I further confirm that:

    a) all significant retirement benefits, including any arrangements that are:

       - statutory, contractual or implicit in the employer's actions;
       - arise in the UK and the Republic of Ireland or overseas;
       - funded or unfunded; and
       - approved or unapproved,

       have been identified and properly accounted for; and

    b) all plan amendments, curtailments and settlements have been identified and properly accounted for.

Yours faithfully,

Gareth Waterson, BAcc, CA
Section 95 Officer

27 November 2023

<u>Appendix to the Pension sub-committee Representation Letter of *Orkney Islands Council Pension Fund*: Definitions</u>

Financial Statements

A complete set of financial statements comprises:

- Net Assets Statement as at the end of the period;
- Pension Fund Account for the period
- notes, comprising a summary of significant accounting policies and other explanatory information.

Material Matters

Certain representations in this letter are described as being limited to matters that are material.

IAS 1.7 and IAS 8.5 state that:

“Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information. The following are examples of circumstances that may result in material information being obscured:

a) information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear;
b) information regarding a material item, transaction or other event is scattered throughout the financial statements;
c) dissimilar items, transactions or other events are inappropriately aggregated;
d) similar items, transactions or other events are inappropriately disaggregated; and
e) the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity’s general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity’s own circumstances.

Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.”

Fraud

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation.

Error

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorised for issue; and
b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Management

For the purposes of this letter, references to "management" should be read as "management and, where appropriate, those charged with governance".

Related Party and Related Party Transaction

Related party:

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to in IAS 24 *Related Party Disclosures* as the "reporting entity").

a) A person or a close member of that person's family is related to a reporting entity if that person:
    i. has control or joint control over the reporting entity;
    ii. has significant influence over the reporting entity; or
    iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
b) An entity is related to a reporting entity if any of the following conditions applies:
    i. The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
    ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
    iii. Both entities are joint ventures of the same third party.
    iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
    v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
    vi. The entity is controlled, or jointly controlled by a person identified in (a).
    vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

viii. The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Key management personnel in a local authority context are all chief officers (or equivalent), elected members, the chief executive of the authority and other persons having the authority and responsibility for planning, directing and controlling the activities of the authority, including the oversight of these activities.

A reporting entity is exempt from the disclosure requirements of IAS 24.18 in relation to related party transactions and outstanding balances, including commitments, with:

a) a government that has control or joint control of, or significant influence over, the reporting entity; and
b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

Related party transaction:

A transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Appendix 2

Orkney Islands Council Pension Fund

Audit for the year ended 31 March 2023

Prepared on 16 November 2023

For presentation on 22 November 2023

Key contacts

Your key contacts in connection with this report are:

Julie Radcliffe
Director
Tel:+44 7881503241
julie.radcliffe@kpmg.co.uk

Kunal Malhotra
Manager
Tel: +44 7510374796
Kunal.malhotra1@kpmg.co.uk

Contents	Page

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Introduction

To the Pension Fund Sub Committee of the Orkney Islands Council Pension Fund

We are pleased to have the opportunity to meet with you on 22 November 2023 to discuss the results of our audit of the annual accounts of Orkney Islands Council Pension Fund as at and for the year ended 31 March 2023.

We are providing this report in advance of our meeting to enable you to consider our findings and hence enhance the quality of our discussions. This report should be read in conjunction with our audit plan and strategy report, presented on 18 May 2023. We will be pleased to elaborate on the matters covered in this report when we meet.

There have been no significant changes to our audit plan and strategy, other than consideration of going concern (see page 19).

We expect to issue an unmodified Auditor's Report, subject to the satisfactory completion of the outstanding matters noted on page 5.

We draw your attention to the important notice on page 4 of this report, which explains:

- The purpose of this report;
- Limitations on work performed; and
- Restrictions on distribution of this report

Yours sincerely,

Julie Radcliffe

How we have delivered audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define 'audit quality' as being the outcome when audits are:

- ❑ **Executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls** and
- ❑ All of our related activities are undertaken in an environment of the utmost level of **objectivity**, **independence**, **ethics** and **integrity**.

Audit Scotland (AS) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Board.

External auditors do not act as a substitute for the Board's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Important notice

Purpose of this report

This report has been prepared in connection with our audit of the annual accounts 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 key issues identified during our audit but does not repeat matters we have previously communicated to you.

Limitations on work performed

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.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries

Status of our audit

Our audit is complete, subject to the satisfactory completion of the outstanding matters noted on page 5. and matters communicated in this Report may change pending signature of our audit report. We will provide an oral update on the status.

Restrictions on distribution

The Report is provided on the basis that it is only for the information of the Beneficiaries; that it will not be quoted or referred to, in whole or in part, without our prior written consent; and that we accept no responsibility to any third party in relation to it.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Executive Summary

The purpose of this audit report is to set out the significant issues that came to our attention during the course of the audit of the Orkney Islands Pension Fund (‘the Fund’) for the year ended 31 March 2023.

Our objective is to use our knowledge of the Fund, gained during our routine audit work, to make useful comments and suggestions for you to consider. However, you will appreciate that our routine audit work is designed to enable us to form opinion on the Scheme’s financial statements and it should not be relied upon to disclose all irregularities that may exist, nor to disclose errors that are not material to the financial statements.

Our work is not intended to provide assurance in relation to individual member records and transactions. In particular we have not checked benefit calculations to LGPS Regulations where such amounts are not individually material to the financial statements.

Audit conclusions	
✓	Unqualified audit opinion on annual accounts.
Areas of audit focus	
✓	No significant accounting issues arose during the course of our audit. Accounting policies appropriate for the Fund Annual Report and Annual Accounts are in accordance with financial reporting framework.
✓	No significant audit issues arose during the course of our audit.
X	We have noted a number of disclosure adjustments as noted in Appendix 3.
✓	We are pleased to note that there are no unadjusted audit misstatements.
Regulatory matters	
✓	No regulatory breaches came to our attention during the course of our normal audit work.
Systems and controls	
✓	No major weaknesses in the financial systems were identified. We have noted a number of control observations in Appendix 2.
Outstanding matters	
	Receipt of signed financial statements Receipt of signed letter of representation Receipt of post balance sheet inquiries

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Management override of controls

Significant audit risk

The risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant. In accordance with International Standards on Auditing (ISA) (UK) 240 'The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements', we are required to consider the possibility of fraud throughout our audit and undertake specific procedures which we report to the administering authority and the Pensions Board in respect of financial reporting fraud. Two types of intentional misstatements are relevant to our consideration of fraud in our financial statement audit – (i) misstatements arising from fraudulent financial reporting; and (ii) misappropriation of assets. Our approach to fraud takes account of the general and specific risks arising from the general business environment and Orkney Islands Council Pension Fund's own business model
- 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 response

- Our audit methodology incorporated the risk of management override as a default significant risk.
- We assessed accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.
- We evaluated the selection and application of accounting policies.
- We assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.
- We assessed the business rationale and the appropriateness of the accounting for significant transactions that are outside the component's normal course of business, or are otherwise unusual.
- We made enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Management override of controls

Significant audit risk

Our response (continued)

- In line with our methodology, we evaluated the design and implementation of controls over journal entries, cash and post closing adjustments. In view of the revision to ISA 315, in the current year this also mandated reviewing the design and implementation of automated controls used in the financial reporting process, where automated controls were in place.
- 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.

Our findings

We confirm that we have not identified any significant control issues during the course of our audit.

As part of our audit work we may seek to identify controls over significant account balances and transactions within the financial statements, evaluate their design and implementation and in some but not necessarily all circumstances test the operating effectiveness of these controls. Alternatively, if we are able to obtain sufficient appropriate audit evidence through substantive procedures we may choose not to identify, evaluate and test controls as part of our audit.

Observation

We have not identified any indication of management override in the year leading to material misstatement or significant concern. We have reviewed the accounting records and obtained assurance that there were no transactions outside normal business processes.

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.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Audit risks and our audit approach

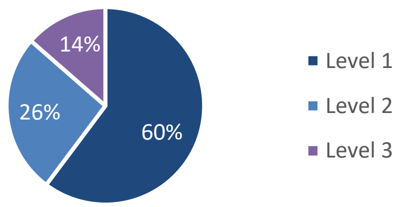
Incorrect valuation of Levels 1, 2 and 3 Investments

Other audit risk

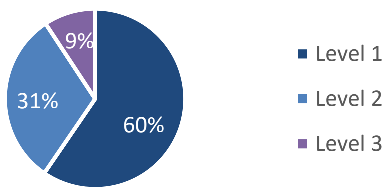
Level 1	Level 2	Level 3
• The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.	• Valuation techniques using inputs that are observable (i.e. developed using market data) either directly or indirectly.	• Valuation techniques using inputs that are unobservable (i.e. for when market data is unavailable)

- — Investments held by the fund at the year end have been classified in accordance with the fair value hierarchy – shown in the first pie chart opposite. The second pie chart shows the split for the fund in the prior year.
- — We have reviewed the allocation of Fund investments to the levels for reasonableness.

Orkney Islands Council Pension Fund - FY2023



Orkney Islands Council Pension Fund – FY2022



© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Audit risks and our audit approach

Incorrect valuation of Levels 1, 2 and 3 Investments

Other audit risk

Investment portfolio valuation summary

Detailed below is an analysis of investments by investment manager and by type of securities and details the pricing risks associated with each type of investment:

Fund manager	Classification	Economic exposure	Level 1 (£'m)	Level 2 (£'m)	Level 3 (£'m)
Baillie Gifford & Co	Directly held equities	Equity - UK quoted	45		
Baillie Gifford & Co	Directly held equities	Equity – Overseas quoted	240		
Baillie Gifford & Co	Pooled Investment Vehicle (PIV)	British Small Companies		1	
Baillie Gifford & Co	Pooled Investment Vehicle (PIV)	Multi Asset Growth Fund		45	
Baillie Gifford & Co	Pooled Investment Vehicle (PIV)	Diversified Growth Fund		46	
LGIM	Pooled Investment Vehicle (PIV)	Fixed Income Fund		33	
IFM	Pooled Investment Vehicle (PIV)	Infrastructure Fund			23
Barings	Pooled Investment Vehicle (PIV)	Private Debt Fund			42
Baillie Gifford & Co	Directly held cash	Cash & Deposits	4		
Total			289	125	65

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Incorrect valuation of Levels 1, 2 and 3 Investments

Other audit risk

The risk

Incorrect valuation of investments (Levels 1, 2 and 3).

Our response

We confirmed our understanding of the processes and controls in relation to the recording of investment transactions in the annual accounts.

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.

Our approach in relation to valuation for different types of investments was as follows:

Segregated investments

- Our in-house investment team, iRADAR, were employed to verify the segregated securities and identify stale price issues of directly held financial instruments within the investment portfolio as well as any exposures to hard to value assets.

Pooled Investment Vehicles (Level 2)

- We verified the pricing of the pooled investment vehicles at the year to an external pricing source, using iRADAR.
- 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 also reconciled the closing unit holdings based on audited prior period position and purchases and sales transactions reported by the investment managers.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Incorrect valuation of Levels 1, 2 and 3 Investments

Other audit risk

Pooled Investment Vehicles (Level 3)

- Level 3 pooled investment vehicles (PIVs) include private equity funds and infrastructure funds.
- We reconciled the closing unit holdings based on audited prior period position and purchases and sales transactions reported by the investment managers.
- We obtained and review the latest audited financial statements for the underlying funds, where available:
  - 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.
  - We completed a hindsight analysis, which involves comparing the latest audited financial statements to reported NAV for the Fund at the same date to check if there have been any significant changes to the valuation.

Our findings

The segregated investments were valued by iRADAR with no significant differences.

We noted that the equity pooled fund of £1.205m was included in equities. This is a pooled fund and we raised an adjustment to be reclassified as a PIV (see Appendix 3).

No other issues were noted as a result of our work.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Inaccurate or late contributions

Other audit risk

The risk

- Inaccurate or late contributions.
- Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. Revenue in a pension fund equates to contributions receivable. Contributions relate to the actual amounts paid or due to be paid under an agreed schedule, plus other amounts as determined by the government 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. There is little incentive for the local pension board to manipulate the financial reporting of contributions. 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.

Planned response

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;
- Agreed active members per the membership statistics to the number of active members paying contributions in the final month's remittance statements and the amount received per the nominal ledger to the final month's remittance statement from the employer;
- 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; and
- Ensured strain costs are in line with the agreed amounts.

Our findings

We note that strain costs are £nil in the year.

No issues were noted as a result of our work.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Audit risks and our audit approach

Misstatement of Cash

Other audit risk

The risk

- Misstatement of pension fund cash at bank.

Planned response

Our audit will include:

- 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.

Our findings

No issues were noted as a result of our work.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Change in market value and/or investment income misstated

Other audit risk

The risk

Change in market value and/or investment income misstated.

Our response

- 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 accounts.

Our findings

For the level 3 PIVs; opening to closing investment reconciliation disclosed as part of notes to accounts were containing balances related to purchases/sales made during the year were recorded on net basis, instead of grossing up. This did not impact affect the closing value of investment assets as at year end. We raised an audit adjustment to correct this disclosure (See Appendix 3).

No other issues were noted as a result of our work.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Incorrect benefit payments

Other audit risk

The risk

Incorrect benefit payments.

Our response

— 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; and
- ❑ Agreeing pensioners per the membership statistics to the number of pensioners paid per the final month's pensioner payroll and the amount paid per the nominal ledger to the final month's pensioner payroll.

— 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; and
- ❑ Review of after date payments to ensure no unrecorded liabilities and to ensure cut off is correct.

Our findings

No issues were noted as a result of our work.

Control observation

As part of our review of processes we noted that management do not perform a detailed member reconciliation. However, we recommend management considers performing a perform regular reconciliation of members data and agree the details to the underlying payroll data (See Appendix 2).

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Audit risks and our audit approach

Incorrect financial statement presentation

Other audit risk

The risk

Incorrect financial statement presentation.

Our response

— We have reviewed the Fund's annual report and accounts and checked them against the disclosure requirements of CIPFA Code Disclosure checklist.

— We have also reviewed the Fund's accounting policies and management's judgement in relation to subjective areas of accounting.

— Our audit included completion of our financial statement disclosure checklist, which takes account of the requirements of the Code of Practice.

— As part of our procedures on other information, we obtained and read disclosures. We consider whether there is a material inconsistency between this information included in the annual report and accounts, or with our knowledge obtained in the audit; or whether this information appears to be materially misstated.

— We have read the Other Information (comprising the Management Commentary, the Statement of Responsibilities for the Annual Accounts, Annual Governance Statement, Governance Compliance Statement and other reports) and checked it for consistency with the annual accounts and our knowledge gained throughout the audit process. As auditor, we look for material inconsistencies, but have not verified any of the detailed disclosures.

Valuation of present value of promised retirement benefits

— In addition, given the requirement to disclose the actuarial liabilities position of the Fund as at 31 March 2023; we have obtained actuarial valuation details from the Actuary and use our actuarial specialists to ensure that the related disclosures are appropriate.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Incorrect financial statement presentation

Other audit risk

The risk

Incorrect financial statement presentation.

Our findings

We noted a number of disclosure misstatements as set out in Appendix 3.

We also noted a number of other minor presentation and typographical changes.

Control observation

We recommend management to perform a detailed review of the draft accounts, with reference to the technical briefing notes released by Audit Scotland and the CIPFA (Example accounts and disclosure checklist). (See Appendix 2).

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit risks and our audit approach

Incorrect financial statement presentation
Disclosure: Valuation of present value of promised retirement benefits

Other audit risk

The risk

- 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 annual accounts disclose the assumptions used by the Fund in completing the valuation.

Our response

- 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

Our findings

No issues were noted as a result of our work.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Audit risks and our audit approach

Going concern

Other audit risk

The risk

Incorrect use of going concern concept

Our response

— We obtained the OIC's assessment of the going concern of the Fund.

— Evaluated how the risk assessment process identifies risks relating to events and conditions that may cast significant doubt on the Fund's ability to continue as a going concern.

— Evaluated the information the used in its assessment, including the work of experts (e.g. Fund actuary, Fund covenant adviser) and evaluated how events and conditions are captured that may cast significant doubt on the Fund's ability to continue as a going concern.

— Evaluated whether the assessment has failed to identify events or conditions that may cast significant doubt on going concern, and whether the method used by the OIC is appropriate.

Our findings

We have received the going concern assessment for the Fund and consider the going concern basis of preparation appropriate given the current level of funding.

The basis of preparation note was updated to note that the going concern concept assumes that the Pension Fund has adequate resources to realise its assets and meet benefit obligations in the normal course of affairs (continue to operate) for at least twelve months from the date of approval of the accounts.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Wider Scope

The new Code of Audit Practice has refreshed the areas used to define the wider audit scope. The previous 2016 edition set out four areas (described as audit dimensions), i.e. financial management, financial sustainability, governance and transparency, and value for money.

The new Code no longer uses the term audit dimensions, but it retains the areas of financial management and financial sustainability (though redefines each area) and replaces the other two as follows:

- ❑ governance and transparency dimension has been replaced with vision, leadership and governance area; and
- ❑ value for money dimension has been replaced with use of resources to improve outcomes.

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

- **Financial management** – Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Vision, leadership and governance** – Vision, Leadership and Governance is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Use of resources to improve outcomes** – Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

In addition to the four wider scope for 2022/23 Audit Scotland have also mandated that for their National Risk Assessment all bodies are assessed for:

- **Climate Change** – The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change. There are specific legal responsibilities placed on public bodies to contribute to reducing greenhouse gas emissions, to adapt to climate change, to act sustainably and to report on progress.
- **Cyber Security** – There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place. A number of recent incidents have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Financial Management

Scope

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

Areas of Focus

- the arrangements to ensure effective systems of internal control, to ensure public money is applied within the relevant financial rules;
- the effectiveness of the budget control system to communicate accurate and timely financial performance to meet the needs of the user;
- the accuracy and embeddedness of financial forecasting within financial management and financial reporting arrangements, including achievement of financial targets;
- the arrangements taken to link budget setting, savings plans to the priorities and risks of the Board; and
- the capacity and skills of the Board's finance team

Our findings

We noted that Fund performance levels in 2022-23 were below target and the value of the Fund fell, however, the Fund still has sufficient assets to cover its liabilities.

❑ Effectiveness of the system of internal controls

There is no separate internal audit department at pension fund, instead uses the Orkney Islands Council internal audit department, who will perform audit and release report.

It was noted that the Council Internal Audit team conducted a review of the processes and controls for pensions administration during the year. The overall conclusion was that the framework of governance, risk management and control were found to be comprehensive and effective.

As part of our review, we did not consider the approach adopted to develop the annual internal audit plan.

❑ Fund has appropriate and effective financial management arrangements in place

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.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Financial Management

❑ Budgetary process

Establishment of an annual service budget in advance of financial year, with monthly budget monitoring reports prepared by officers and quarterly budget reports to the Pension Fund Sub-committee, forms part of the governance arrangements for the Pension Fund.

The budget covers four key areas; OIC member benefits and contributions; Admitted and Scheduled Bodies member benefits and contributions, pensions administration costs and investment activities.

The draft budget for the Pension Fund for 2023/24 has been prepared using the base-line budget for 2022/23 as a starting point and factors in the following key inflationary assumptions:

- 10.1% increase in pensions payable.
- 6.0% increase in salaries.
- 6.0% increase in apportioned costs.

Monthly budget monitoring reports prepared by officers and quarterly budget reports to the Pension Fund Sub-committee, forms part of the governance arrangements for the Pension Fund.

The Pensions Sub Committee also receives an Outturn report which includes a reconciliation between the budgetary position and the numbers in the financial statements.

There are no savings targets applied for the last couple of years due economic environment.

❑ Arrangements for prevention and detection of fraud and error

The Fund relies on the Council’s arrangements for the prevention and detection of fraud and corruption.

The Fund’s Risk Register is reviewed annually. It clearly demonstrate the Fund’s current threats relative to the individual risks anticipated, and a summary and prioritisation of risks to indicate the descriptive risks ranking.

The Fund has in place processes to monitor transfers out for fraudulent activity and mandatory training in place for all finance staff to increase awareness of potential fraud.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Financial Management

❑ Capacity and skills of the Finance Team

Administration of the Fund is carried out by the Council as Administering Body and undertaken by the Payroll and Pensions section within Orkney Islands Council's Enterprise & Sustainable Regeneration Service.

The Pensions team within the Payroll and Pensions section has 3.7 full time equivalents, consisting of a Service Manager, one full time Team Manager, two part time Senior Assistants and an Administrative Assistant. In addition to maintaining scheme members' records using data supplied by all Fund employers, the Pensions team also provides frontline services to scheme members. As well as answering telephone calls and responding to electronic and written correspondence, meetings are provided where requested.

The staff resources detailed above are supplemented by shared staff resources within the Enterprise & Sustainable Regeneration Service, providing additional governance, payments, investment, and accounting expertise. In addition, the Human Resources and Organisational Development section, within Orkney Islands Council's Strategy, Performance & Business Solutions Service also supports the work of the Pension section by arranging pre-retirement workshops for scheme members who are within two years of retirement.

All administration staff have training regularly and those members of the finance team are able to attend the Pensions Sub Committee meeting and attend the training sessions given to those members. A training log is maintained of attendance at the meetings and training sessions. This ensures those members of staff have the appropriate skills to perform their duties. All pensions employees have access to Altair TEC which provides comprehensive training on all aspects of the Altair system functionality, including: Benefit Calculations, Employer Calculations, Legislation and Periodic Processes. Any new employees would complete all relevant modules as soon as possible.

Overall we have not identified any significant risks in this area.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Financial Sustainability

Scope

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Areas of Focus

- Are arrangements in place to balance any short-term financial challenges and cashflow requirements and longer term financial sustainability?
- Are investment decisions informed by clear business cases?
- Is it clear how investments will be funded and how success will be measured?
- Are the benefits of investment clearly articulated at the outset and how is success measured?

Our findings

❑ Financial planning arrangements

The funding policy is set out in the Administering Authority's Funding Strategy setting out the key funding principles.

The Pension Fund is governed by the Local Government Pension Scheme (Scotland) Regulations. These include requirements for the preparation and production of a number of key policy documents including a Valuation Report, a Funding Strategy Statement and Statement of Investment Principles.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Financial Sustainability

❑ Development of financial recovery plans

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. 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.

The funding level increased by 22% to 159% from 137% in 2021-22, however, the significant fall in the value of the liabilities in 2022-23 means that the Fund has still increased since the triennial valuation.

The Fund is about to undergo another actuarial valuation report as at 31 March 2023 and in preparation for this the Pensions Sub Committee received a presentation from the Actuary to help them prepare for the process and the decision making involved, as well as a presentation from the investment advisor to understand the investment strategy in the current economic climate the to ensure the investment decision making process is linked to the liabilities of the pension fund and that the employer contribution rate is considered carefully to ensure the surplus is not eroded.

❑ Medium term financial plan

As note above the Fund prepares an triennial valuation looking forward and 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.

❑ Monitoring performance against the plan

The Actuary provides an annual update to monitor the financial position of the Fund against its liabilities and reports accordingly to the Pensions Sub Committee.

❑ Significant investment decisions

We have noted on page 36 the post year end investment decision and the investment monitoring arrangements are noted on page 35.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Financial Sustainability

❑ Consideration of the stage of maturity of the Fund on financial sustainability

Membership of the Fund increased by 136 to 4,475 members at 31 March 2023; an increase in membership of 3.13%. The impact of auto-enrolment continues to contribute to the increase in employee members. During 2022-23, the number of pensioners receiving a pension from Orkney Islands Council Pension Fund increased by 66 members 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 rate of employer contributions

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%.

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

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.

The approximate split of all contributions received in year is as below:

Description	Orkney Islands Council (£'m)	Admitted Bodies (£'m)	Total (£'m)
Employer contributions	7.81	0.91	8.72
Employee contributions	2.80	0.35	3.14
Strain contributions	-	-	-

Source: Orkney Islands Council Pension Fund 2022/23 unaudited financial statements

Overall we have not identified any significant risks in this area.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Vision, Leadership and Governance

Scope

Vision, Leadership and Governance is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Areas of Focus

- the vision and strategy of the Pensions Committee, to ensure it includes a clear set of priorities which reflects the pace and depth of improvement that is need to realise the Pension Funds priorities and long term sustainability of services to meet the needs of the members.
- the governance arrangements are appropriate and operating.
- assess the evidence that demonstrates leaders are adaptive to the changing environment.
- the culture of the Board and how it operates with partners to understand their roles and responsibilities to help deliver the priorities of all partners.

Our findings

Orkney Islands Council, the administering authority has delegated its responsibility for governance of Fund to Pension Fund Sub-Committee. The Pension Fund Sub-Committee is supported by a Pension Board in compliance with regulations and the requirements of the Pensions Regulator.

We note that the Council has a Local Code of Corporate Governance as well as a Scheme of Administration document setting out the terms of reference of the various committees including those of the Pensions Fund Sub Committee as well as the Pensions Board.

Following the local government elections in May 2022, a new Sub-Committee was appointed. 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.

The Fund prepares an annual training plan to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively. This was last updated in February 2023 setting out a clear plan for 2023. There is a training log maintained to monitor attendance at meetings and a competency matrix for members.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Vision, Leadership and Governance

The Fund also has an Investment Business Plan considering the key objectives of the Fund over the period to June 2024, demonstrating consideration of the strategy and implementation, monitoring and reporting, responsible investment, governance and training; as well as planned interaction with the investment managers over the period.

❑ **Communications with stakeholders**

The stakeholders refers to members of pension fund. The Fund has an external website for members helps in explaining the governance of the fund and how it is run including multiple standard tools such lump sum calculator, contribution calculator, annual allowance details etc. In addition, annual benefit statements are shared with them and the Annual Report and Accounts is available on the website.

❑ **Performance reporting**

The Pension Fund Sub Committee is provided with reports on financial performance, from the Actuary in relation to consideration of actuarial position of the Fund. Hymans Robertson LLP also provides independent performance measurement services for the Fund and has responsibility for measuring and reporting on the performance of the Fund during the year.

Management Commentaries are included in the annual accounts to provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of the Fund’s performance as well as helping stakeholders understand the accounts.

The Fund’s 2022-23 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.

The accounts include information in relation to performance both of the administration team and the investment managers.

The Annual Report and Accounts also provides an Annual Governance Statement.

❑ **Decision making process**

Pension Fund do not possess a separate document for decision making re financial regulations, standing orders, etc. instead uses same as administrator's i.e., Orkney Islands Council. It includes multiple items covering role and responsibilities starting from Section 95 officer, Breach of Regulations, Financial planning and administration, Budgetary controls and Financial monitoring.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Vision, Leadership and Governance

❑ Risk Management and Board Assurance Framework

A risk register is prepared at Fund level which sets out the risks faced by the Fund at both assessing the risk for likelihood and impact. Risks are evaluated on a 1-10 score. The register clearly notes the mitigation controls in place, an owner as well as a target date/priority items.

The risk register is reviewed annually and updated as appropriate. The last update was 15 February 2023, when it was updated to consider the changes since COVID 19 and the recent disruption to the global stock markets.

A regular review of the risk register and considerations of the current economic environment on risks demonstrates that those charged with governance are adaptive to change. This is further demonstrated in their challenge of investment managers to embed change and themselves investing in a net zero fund (see page 36).

❑ Cultures and values

These are set out in the Orkney Islands Council Local Code of Corporate Governance.

The key areas of responsibility for the Fund is set out in the above document in the Scheme Administration section; which sets our the roles and responsibilities of the members of the Pensions Board and the Pensions Sub Committee.

The basis of communications arrangements with other stakeholders is set out in those terms of engagement with those advisers such as the investment managers, custodian, actuary and investment advisors.

❑ External performance reporting

As noted above the Fund uses their external advisors to monitor investment performance against benchmarks and the investment strategy for the Fund.

Overall we have not identified any significant risks in this area.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Use of Resources to Improve Outcomes

Scope

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

Areas of Focus

- The arrangements in place to demonstrate that there is a clear link between money spent and outputs and the outcomes delivered.
- The arrangements to evaluate service delivery and quality and whether the user needs and views are included in any such evaluation.

Our findings

❑ General administration arrangements

There is a Pensions Administration Strategy document (October 2023) which outlines key objectives as well as the roles and responsibilities of the Council as the administering body for the Fund, as well as setting performance standards for both the Council and its Employer as administering authority and the Employer.

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. In addition, the Employers are provided with an annual performance report.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Use of Resources to Improve Outcomes

In the prior year it was noted that service levels were maintained in the majority of areas; however, they did fall in processing transfers in, pension estimates and updating leavers information, primarily due to the delays in the receipt of actuarial figures, but now these are received from the Scottish Ministers.

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 within targets can make significant percentage differences.

❑ Monitoring administration performance against targets

Performance of the administration of the Fund is summarised below

	Performance Standard (days)	Percentage processed within standard 2022/23	Percentage processed within standard 2021/22
Pension estimates	10	95.5%	96.8%
Retirements	5	100.0%	100.0%
Transfers in	10	94.0%	94.4%
Transfers out	10	100.0%	100.0%
Refunds	5	100.0%	84.6%
New Entrants information	10	100.0%	100.0%
Leavers information	10	99.4%	100.0%
Deferred Benefit information	1 Month	100.0%	100.0%

Source: Orkney Islands Council Pension Fund 2022/23 unaudited financial statements

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

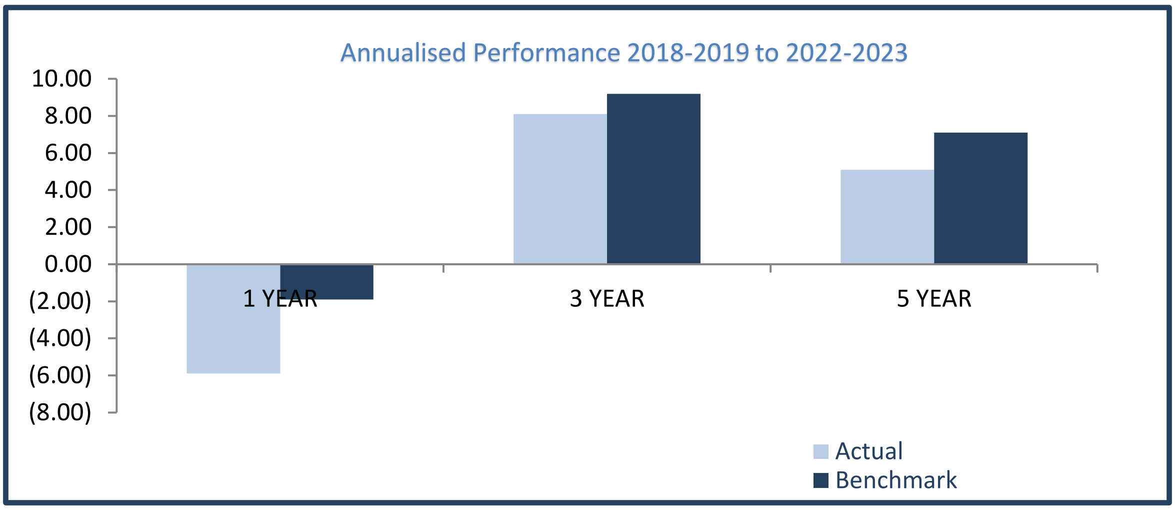
Document Classification: KPMG Confidential

Wider Scope

Use of Resources to Improve Outcomes

❑ Monitoring financial performance against targets and other benchmarks

The continuing impact of inflation and the conflict in Ukraine on global markets reduced annual returns. The Fund appoints four external investment managers. Individual investment manager performance is reviewed regularly by the Pension Fund Sub-Committee. Overall, the Fund has decreased by –5.6% against a benchmark of -1.9%. The following graph summarises investment performance on an annualised basis over 1, 3 and 5-year periods:



Source: Orkney Islands Council Pension Fund 2022/23 unaudited financial statements

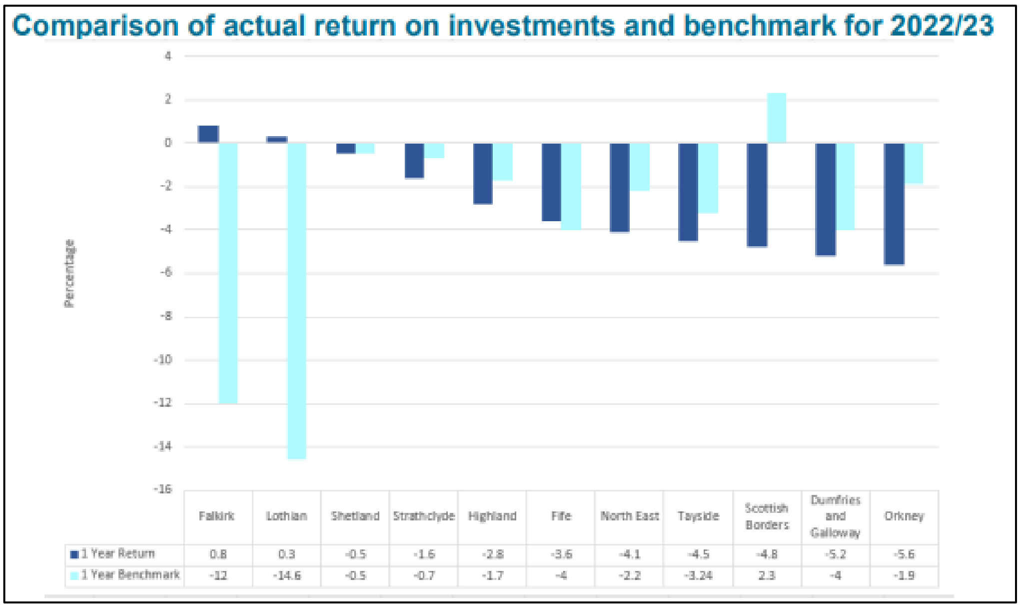
© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Use of Resources to Improve Outcomes

Financial markets have been exceptionally volatile in recent years due to the unstable economic environment. Returns against most asset classes, especially equities reduced due to decrease in market value of investments, outflows for benefits payable & management expenses were offset by investment income & contribution receivable.

The Fund has over 80% of funds invested in growth assets which were impacted adversely by the market volatility in 2022-23. The fund experienced a challenging year in 2022-23 resulting in a negative performance for the year of -5.6%, compared with a benchmark of -1.9%. Other Scottish funds had similar experiences against benchmark in 2022-23 as shown below:



Source: Unaudited annual report and accounts of Pension Fund in Scotland

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Wider Scope

Use of Resources to Improve Outcomes

❑ Use of advisors in decision making

The Pensions Sub Committee made a significant investment in a Net Zero fund post year end. As part of this process they completed due diligence with the help of Hymans Robertson LLP to consider the options available to meet the long term strategic allocation of 10% in infrastructure; with the aim of choosing an provider with a growing focus on responsible investment and climate risks. Hymans Robertson LLP provided a range of options and subsequently provided a short list of renewable infrastructure funds and matters to be considered as part of the selection process.

The Fund has a process in place to perform due diligence when appointing a new investment manager and/or investing in a new fund and demonstrates use of advisors in the decision making process.

❑ Evaluation of investment manager performance

We noted that the Pensions Sub Committee requests the attendance of investment managers at committee meetings throughout the year. We noted evidence of this with Baillie Gifford who were challenged on their investments in certain companies, given the Fund’s focus on ESG, and also to provide some context around their engagement in the companies involved and the voting rights to establish the basis of the engagement with a view to engendering change.

The Pensions Fund Sub Committee actively monitors investment performance and considers investment management expenses as part of the investment managers attendance at the meetings.

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.

Investment management expenses have decreased from £2.231 million in 2021/22 to £2.131 million in 2022/23. Investment manager expenses can vary due to a number of factors including actual return on investments and the nature of investments held. This is due to overall drop in asset values.

❑ Evaluation of investment advisors

It is understood that consideration has not been given in the last 12m to alternative investment advisor.

Pension Sub-committee evaluates the objectives for Hymans Robertson, as investment consultant to the Fund, following the publication of the Competition and Markets Authority (“CMA”) final order, relating to their review of investment consulting and fiduciary management markets. This review was conducted in conjunction with Hymans Robertson in December 2022.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.
Document Classification: KPMG Confidential

Wider Scope

Use of Resources to Improve Outcomes

❑ Use of advisors in decision making

The Pensions Sub Committee made a significant investment in a Net Zero fund post year end. As part of this process they completed due diligence with the help of Hymans Robertson LLP to consider the options available to meet the long term strategic allocation of 10% in infrastructure; with the aim of choosing an provider with a growing focus on responsible investment and climate risks. Hymans Robertson LLP provided a range of options and subsequently provided a short list of renewable infrastructure funds and matters to be considered as part of the selection process.

The Fund has a process in place to perform due diligence when appointing a new investment manager and/or investing in a new fund and demonstrates use of advisors in the decision making process.

In addition, we observed the Actuary and the Investment Advisor in attendance at the Pension Fund Sub Committee meeting providing the members with information to support them in the decision making process for the upcoming triennial valuation process and review of the investment strategy.

Overall we have not identified any significant risks in this area.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Climate Change

Background

The public sector has a key role to play in ensuring that national climate change targets are met and in adapting the impacts of climate change. The Accounts Commission is developing a programme of work on climate change. As part of this work, auditors will initially focus on a body's arrangements for responding to climate change. We will therefore consider whether the fund has developed a strategy and action plan, what targets have been set and how they will be monitored and reported.

Our findings

The Scottish Parliament has set a legally binding target of becoming net zero by 2045, and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

❑ **Targets for reducing emissions and climate change strategy**

The Fund does not have its own specific target for reducing emissions nor a climate change strategy setting out how it intends to meet those targets set.

The Orkney Islands Council (referred as "Council") has a target of 42% CO2e emission reduction by 2024, it is up and running via Carbon Management Programme. The UK government has identified the Local Authority sector as key to delivering carbon reduction across the UK in line with its Kyoto commitments, and the Local Authority Carbon Management programme is designed in response to this.

The responsibility for meeting the targets outlined above lies with the administering authority i.e., Orkney Islands Council (referred as "Council").

The Fund is supporting climate change initiatives through collaboration with the Council and its external fund managers. The Fund believes that by working together, investors can use their collective size to influence decision making and promote the highest standards of corporate governance and corporate responsibility.

The Statement of Investment Principles sets out the considerations of Environmental. Social and Governance (ESG) and has also set out the arrangements for voting rights; the Committee has delegated the exercise of voting rights to the investment managers with reference to ESG considerations.

The Pension Fund Sub Committee have not made explicit allowance for the long-term risks of climate change in their investment strategy. However, the investment managers are expected to take account of all financially material factors in determining their yield/return expectations. Investment managers are required to comment on how they believe their long-term yield and return expectations may be impacted by climate change and any impacts that may arise in the short-term.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Climate Change

❑ Monitoring and reporting of progress to meet targets

As noted above, the Fund does not have its own targets and climate strategy specifically for the Fund.

However, in relation to monitoring, the Fund received a report from Hymans Robertson LLP; Responsible Investment & Climate Risk Report 2022 to consider their investment strategy leading to the recommendation that the climate risk should be embedded in the investment strategy and that there should be greater challenge of investment managers in this area.

The Fund has taken necessary steps to provide training members of Pension Sub-committee in May 2023 with Hymans Robertson LLP providing training; Responsible Investment - TCFD and Carbon foot printing training, so members are able to recognise the impact of ESG factors in investment decision making and to be effective stewards of the investments of the Fund; to make them competent and capable to challenge adequately the investment managers.

❑ Impact of climate change on annual report and accounts

There is currently no requirement for the Fund to include climate change in its narrative reporting which accompanies the financial statements.

Recommendation

The Fund does not have a clear climate strategy with targets set to be aligned to those of the Council. We recommend that a formal strategy be put in place with clear targets for the investment strategy of the Fund to provide the Pension Fund Audit Committee with a focus and basis upon which to monitor performance, both of their strategy and that of the fund managers.

In addition, whilst the risk register considers investment risk, it does not specifically mention risks surrounding climate change. We recommend the risk register be updated to consider specifically climate change.

(See Appendix 2)

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Wider Scope

Cyber Security

Background

There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place. A number of recent incidents have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation.

Our findings

In line with the reporting for the Orkney Islands Council we have not considered this area during the current years audit.

.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Systems and controls

Current year control observations

We confirm that no significant issues came to our attention during the audit, although we do have a number of observations set out in Appendix 2.

Status of prior year control observations

We have reviewed the status of prior year control observations that were outstanding at the end of last year's audit. A summary of their status is set out below:

Type of point	Number of points
Total points outstanding at end of last year's audit ❑ Advertising the financial statements ❑ ISAE3402 Controls reports ❑ Custodian	3
Satisfactorily dealt with	3
Some action taken but not fully implemented	-
Little or no change	-

- As part of our audit work we may seek to identify controls over significant account balances and transactions within the financial statements, evaluate their design and implementation and in some but not necessarily all circumstances test the operating effectiveness of these controls. Alternatively, if we are able to obtain sufficient appropriate audit evidence through substantive procedures we may choose not to identify, evaluate and test controls as part of our audit.
- Our memorandum is designed to include useful recommendations that may help improve performance and avoid weaknesses which could lead to material loss or misstatement. However, it is your obligation to take the actions needed to remedy those weaknesses and should you fail to do so we shall not be held responsible if loss or misstatement occurs as a result.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Appendices

Contents

Mandatory communications

Type		Statement
Our draft management representation letter		We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2023.
Adjusted audit differences		There were a number of audit adjustments noted on page 17
Unadjusted audit differences		There are no unadjusted audit adjustments differences .
Related parties		There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Pensions Board		There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies		We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated in writing.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts		No actual or suspected fraud involving management, employees with significant roles in internal control, or where fraud results in a material misstatement in the financial statements was identified during the audit.
Significant difficulties		No significant difficulties were encountered during the audit.
Modifications to auditor's report		None.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Mandatory communications (cont.)

Type		Statement
Disagreements with management or scope limitations		The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information		No material inconsistencies were identified relating to other information in the statement of responsibilities, annual governance statement, governance compliance statement and remuneration reports.
Breaches of independence		No matters to report. The engagement team have complied with relevant ethical requirements regarding independence.
Accounting practices		Over the course of our audit, we have evaluated the appropriateness of the Orkney Islands Council Pension Fund's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. However we did request clarification in the financial statements regarding a number of accounting policies (see page 17)
Significant matters discussed or subject to correspondence with management		The were no significant matters arising from the audit that were discussed, or subject to correspondence, with management.
Certify the audit as complete		We are required to certify the audit as complete when we have fulfilled all of our responsibilities relating to the accounts and use of resources as well as those other matters highlighted above. At the time of writing this report our audit is not complete.
Provide a statement to AS on your consolidation schedule		We will issue our report to Audit Scotland following the signing of the annual report and accounts.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Appendix 2

Recommendations raised

The recommendations raised as a result of our work in the current year are as follows:

Priority rating for recommendations		
❶ **Priority one:** issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷ **Priority two:** issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately, but the weakness remains in the system.	❸ **Priority three:** issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

#	Risk	Issue, Impact and Recommendation	Management Response/Officer/Due Date
1	❷	**Review of annual report and accounts** We noted during the course of the audit a number of presentational errors in the accounts. There is a risk that the accounts are not fairly presenting the information to a user of the accounts and the disclosures may be inappropriate and incomplete. . We recommend that a thorough peer review process is put in place; with reference to the CIPFA Example Accounts and Disclosure Checklist and other technical briefing notes as released by Audit Scotland, while preparing the annual accounts. .	**Agreed.** Reference to technical briefing note will be made while preparing the annual report and accounts. LGPS example accounts and disclosure checklist will be provided by KPMG on an annual basis, to allow time for a peer process review to take place. **Officer responsible:** Service Manager – Corporate Finance **Due date:** 30 June 2024

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Recommendations raised (Cont.)

#	Risk	Issue, Impact and Recommendation	Management Response/Officer/Due Date
2	2	**Membership reconciliation** We noted that no formal member reconciliation is performed noting membership changes in the year, reconciling movements and cross checking against the underlying payroll records. There is a risk that membership information may be incorrect. We therefore recommend that the Fund considers performing an annual membership reconciliation to ensure the completeness and accuracy of member records, which should be checked against the underlying payroll records for active and pensioner members at the year end.	**Agreed**: A review of the current monthly processes will be undertaken to ensure the risk of incorrect membership data is minimised, and if required an annual membership review will be added to those procedures. **Officer responsible:** Service Manager – Payroll and Pensions **Due date:** 31 March 2024
2	2	**Climate Strategy** We note that the Fund does not have its own climate strategy. There is a risk that the investment decision making process is not aligned to that the Council and there may be missed risks and potential opportunities not identified. We recommend that the Fund implements its own climate strategy, aligned to that of the Council; which can be embedded in its overall investment strategy to ensure meeting the targets set. In addition, we recommend the risk register is updated to reflect the risks posed by climate change.	**Agreed**. A review of the Fund's responsible investment beliefs has been undertaken and a report on the outcome will be presented to the Sub-committee on 22 November 2023. The findings of this review will be used to develop a Responsible Investment Policy which will detail the Fund's approach to ESG and climate change. **Officer responsible:** Service Manager – Corporate Finance **Due date:** 30 June 2024

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Audit Differences

Under UK auditing standards (ISA (UK) 260) we are required to provide the Pensions Board with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Pensions Board, details of all adjustments greater than £240K are noted low

There are a number of audit adjustment in relation to disclosure as noted below:

- ❑ Accounting policies were updated to include a policy for benefits payable and taxation
- ❑ The accounting policy in relation to the investment income was updated to clarify the basis of recognition of investment income; particularly where the PIV income is wrapped up in the unit price and taken account of in the change in market value of investments
- ❑ Basis of preparation note was updated to be clear that the accounts had been prepared on a going concern basis
- ❑ The contributions accounting policy was updated to clarify the basis upon which the contributions are recognised for the Employer and Employee contributions
- ❑ Risk disclosures were updated to include:
    - ❑ interest rate risk exposure on the bond funds,
    - ❑ credit risk exposure on pooled funds and cash held with fund managers and
    - ❑ currency risk exposure on cash held with fund managers
- ❑ Contractual commitments note updated to reflect the remaining capital commitment at the year end for the pooled funds
- ❑ Update to the AVC valuation at the year end following receipt of information
- ❑ Update for the related party note to include reference to the pension board and sub-committee members
- ❑ Reclassification of the equity fund (see page 11)
- ❑ Grossing of purchase / sales in investment reconciliation for the level 3 PIVs (see page 11)
- ❑ Statement of responsibilities was updated to correct references to applicable laws and regulations.

There are no unadjusted audit differences.

KPMG

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Appendix 4

Confirmation of Independence

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

To the Audit Committee members

Assessment of our objectivity and independence as auditor of the Orkney Islands Council Pension Fund

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners/directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard.

As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

© 2022 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Confirmation of Independence (cont.)

We have considered the fees charged for audit professional services during the reporting period. Total fees charged by Audit Scotland are:

	2022/23
	£'000
Audit of Fund	25
Total audit	
Total non-audit services	-
Total Fees	25

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit and Compliance Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

© 2022 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Appendix 5: ISA (UK) 315 Revised: Overview

Summary

ISA (UK) 315 *Identifying and assessing the risks of material misstatement* incorporates significant changes from the previous version of the ISA. These have been introduced to achieve a more rigorous risk identification and assessment process and thereby promote more specificity in the response to the identified risks. The revised ISA is effective for periods commencing on or after 15 December 2021.

The revised standard expands on concepts in the existing standards but also introduces new risk assessment process requirements – the changes will have a significant impact on our audit methodology and therefore audit approach.

Why have these revisions been made?

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities (and their governance structures) becoming more complicated, standard setters recognised that audits need to have a more robust and comprehensive risk identification and assessment mechanism.

The changes are aimed at (i) promoting consistency in effective risk identification and assessment, (ii) modernising the standard by increasing the focus on IT, (iii) enhancing the standard's scalability through a principle based approach, and (iv) focusing auditor attention on exercising professional scepticism throughout risk assessment procedures.

What does this mean for an audit?

To meet the requirements of the new standard, auditors will be required to spend an increased amount of time across the risk assessment process, including more detailed consideration of the IT environment. We expect these changes to result in significantly increased audit effort levels which will, in turn, affect auditor remuneration. This additional effort is a combination of time necessary to perform the enhanced risk assessment procedures and the anticipated need to involve more technical specialists (particularly IT Audit professionals) in our audits.

© 2022 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Appendix 5: ISA (UK) 315 Revised: Summary of key changes (Cont.)

Area	Impact on audit effort	Summary of changes and impact
Increased professional scepticism		Increased focus on applying professional scepticism – particularly the need for auditors not to bias their approach towards obtaining evidence that is corroborative in nature or excluding contradictory evidence, which requires more independent evidence to be sought. In all cases, there will be enhanced documentation requirements in this area.
Understanding the entity		Requirements to obtain an understanding of the entity have been restructured and enhanced. The changes are focused on the importance of understanding the applicable financial reporting framework and the entity's accounting policy choices, as well as the extent of IT usage in the business' processes. This will result in increased risk assessment procedures and documentation requirements.
Understanding internal control		The previous standard included requirements for understanding components of the entity's system of internal control. The revisions add another step by requiring auditors perform evaluation procedures over these. This may require additional effort to evaluate the entity's processes over risk assessment and monitoring activities over internal control systems to assess their appropriateness to the entity's size and complexity.
IT systems and communication		The requirements introduce an increased focus on understanding the entity's own management of IT. This may entail performing additional risk assessment procedures and taking a broader view across the IT environment, considering more systems and systems in greater depth, than previously. Given the complexity and specialist knowledge required to perform these procedures, increased use of IT Auditors will be a natural consequence of this revision.
Control activities		The revised standard enhances the way we identify IT applications and aspects of the IT environment that are subject to assessed risks arising from IT. This may result in significant expansion of risk assessment procedures to obtain and evaluate the necessary information. Further, the standard adds new requirements in control testing activities to mandate evaluation of general IT controls that address risks arising from IT associated with significant risks and certain journal entries. For these controls, the auditor is required to evaluate the design and implementation of the individual controls. This could result in a significant change in approach, with more emphasis and effort spent on evaluating control activities. Again, we anticipate integrating more specialised expertise into our audit team to meet the revised requirements.
Identifying and assessing risks		The changes require more detailed assessment of risks at both the financial statement and assertion levels for classes of transactions, account balances and disclosures than previously. Further, the revisions introduce an inherent risk spectrum and new inherent risk assessment factors, each of which the auditor evaluates to assess the level of risk and thereby shape the audit response. This will increase the audit effort needed to evaluate and document the risks of material misstatement.
Control risk		New requirement to assess inherent risk and control risk separately for each risk of material misstatement identified where the auditor plans to test the operating effectiveness of controls. The separation of assessments will require individual attention, increased documentation and is likely to affect sample sizes for substantive procedures.
Stand-back assessment		New requirement to perform a stand-back assessment for material classes of transactions, account balances or disclosures which have not been identified as significant, to assess whether this determination remains appropriate in the context of the overall audit. This will require increased consideration of aggregation risk and introduce additional documentation requirements.

© 2022 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential

Impact of new standards - ISA (UK) 240 Revised

Summary and background

ISA (UK) 240 *The auditor’s responsibilities relating to fraud in an audit of financial statements* includes revisions introduced to clarify the auditor’s obligations with respect to fraud and enhance the quality of audit work performed in this area. The revised ISA (UK) is effective for periods commencing on or after 15 December 2021. Unlike ISA (UK) 315 which mirrors updates in the international ISA, the updated UK fraud standard is not based on international changes by the IAASB.

The impact of the revisions to ISA (UK) 240 is less extensive compared to ISA (UK) 315, but has nevertheless resulted in changes to our audit approach.

The table below summarises the main changes and our assessment of their impact.

Area	Summary of changes and impact	Effect on audit effort
Risk assessment procedures and related activities	[1] Increased focus on applying professional scepticism – the key areas affected are: — the need for auditors not to bias their approach towards obtaining evidence that is corroborative in nature or excluding contradictory evidence, — remaining alert for indications of inauthenticity in documents and records, and — investigating inconsistent or implausible responses to inquiries performed. [2] Requirements to perform inquiries with individuals at the entity are expanded to include, amongst others, those who deal with allegations of fraud. [3] Every audit now requires a specific determination as to whether to involve technical specialists (including forensics) to aid in identifying and responding to risks of material misstatement due to fraud. This will result in increased involvement of specialists and an expanded scope of work for these specialists, on audit engagements.	
Internal discussions and challenge	Enhanced requirements for internal discussions among the audit team to identify and assess the risk of fraud in the audit, including a requirement to determine the need for additional meetings to consider the findings from earlier stages of the audit and their impact on our assessment of the risk of fraud.	
Communications with management / TCWG	New requirements for communicating matters related to fraud with management and those charged with governance, in addition to the reporting in our audit reports.	

© 2022 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

KPMG

kpmg.com/socialmedia

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

© 2023 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Document Classification: KPMG Confidential