



**Item: 4**

**Pension Fund Sub-committee: 29 May 2024.**

**Orkney Islands Council Pension Fund – External Audit Plan.**

**Report by Head of Finance.**

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## **1. Overview**

- 1.1. Regulation 55 of the Local Government Pension Scheme (Scotland) Regulations 2018 states that councils responsible for administering a pension fund (administering authorities) are required to publish a Pension Fund Annual Report containing the financial statements of the Pension Fund.
- 1.2. Audit Scotland appointed KPMG as external auditor of the Council's Pension Fund for the five-year period from 2022 to 2027. Financial year 2023/24 is the second year of this appointment.
- 1.3. KPMG's responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice and are guided by the auditing profession's ethical guidance.
- 1.4. Following the conclusion of each year's planning process, the external auditor prepares an annual plan detailing the work to be undertaken as part of the annual audit of the Council's Pension Fund. The plan sets out the ways in which KPMG will meet its respective responsibilities under the Code of Audit Practice.
- 1.5. The external audit plan for 2023/24 in respect of the Council's Pension Fund, prepared by KPMG, is attached as Appendix 1 to this report.

## **2. Recommendations**

- 2.1. It is recommended that members of the Sub-committee:
  - i. Note the risk management and planned audit approach to be taken by KPMG during the audit of the 2023/24 Orkney Islands Pension Fund, attached as Appendix 1 to this report.

### **3. Audit Plan 2023/24**

- 3.1. The Annual Audit Plan 2023/24, attached as Appendix 1 to this report, contains an overview of the planned scope and timing of the Pension Fund audit. The plan identifies the work required to provide an opinion on the financial statements and related matters and to meet the wider scope requirements of the public sector audit. The wider scope of public audit contributes to conclusions on the financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes.
- 3.2. KPMG's risk assessment draws on their knowledge of the Fund, its major transaction streams, key systems of internal control and risk management processes, as well as discussions with staff. The following presumed significant risks have been recognised in the audit plan:
- Management override of controls:
    - Professional standards require KPMG to communicate fraud risk from management override of controls as significant.
    - Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
  - Other areas of audit focus:
    - Valuation of investments (Levels 1, 2 and 3).
    - Recording and accuracy of contributions into the Fund.
    - Recording and accuracy of cash balances.
    - Recording and accuracy of benefit payments.
    - Presentation and calculation of actuarial position.
- 3.3. KPMG will provide an independent auditor's report to members of the Council, as the administering authority for the Pension Fund, the Accounts Commission for Scotland and Audit Scotland, setting out its opinions on the annual accounts, and will provide the Pension Fund Sub-committee, the Accounts Commission and Audit Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

- 3.4. The timetable for completion of the audit cycle is to present the annual audit report to the Pension Fund Sub-committee on 19 September 2024, with the annual accounts signed on or before the 30 September 2024 deadline.

**For Further Information please contact:**

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

**Implications of Report**

1. **Financial:**

- Audit Scotland charges a set fee for KPMG undertaking the audit of the Council's Pension Fund. In determining the audit fee, external auditors have taken account of the risk exposure of the Fund, the planned management assurances in place and the level of reliance they plan to take from the work of internal audit. The audit approach assumes receipt of the unaudited annual accounts, with a complete working papers package by 30 June 2024.
- Audit Scotland's fee proposal for the Pension Fund Audit 2023/24 is £26,350 a rise of 6.0% in comparison to the fee of £24,860 for 2022/23. The annual audit fee is paid for from the Pension Fund budget.

2. **Legal:** An external audit and review of the Council's Pension Fund helps the Council to meet its statutory obligation to secure best value.

3. **Corporate Governance:** The Pension Fund Sub-committee has responsibility to discharge all functions and responsibilities relating to the Council's role as administering authority for the Orkney Islands Council Pension Fund, as defined in the Scheme of Administration.

4. **Human Resources:** Not applicable.

5. **Equalities:** Not applicable.

6. **Island Communities Impact:** Not applicable.

7. **Links to Council Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Council Plan strategic priorities:

- Growing our economy.
- Strengthening our communities.
- Developing our Infrastructure.
- Transforming our Council.

8. **Links to Local Outcomes Improvement Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Local Outcomes Improvement Plan priorities:

- Cost of Living.

- Sustainable Development.
- Local Equality.
- 9. **Environmental and Climate Risk:** Not applicable.
- 10. **Risk:** The industry and wider economic environment that the Pension Fund operates in has high levels of risk and therefore it is a requirement for an annual audit to be carried out by an independent auditor appointed to the Council by Audit Scotland.
- 11. **Procurement:** Not applicable.
- 12. **Health and Safety:** Not applicable.
- 13. **Property and Assets:** Not applicable.
- 14. **Information Technology:** Not applicable.
- 15. **Cost of Living:** Not applicable.

### **List of Background Papers**

None

### **Appendix**

Appendix 1 - Orkney Islands Council Pension Fund – External Audit Plan for the year ended 31 March 2024.

# External Audit Plan for the year ended 31 March 2024

**Orkney Islands Council Pension Fund**

**Prepared on 07 May 2024**

**For presentation on 29 May 2024**

## Key contacts

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# **Introduction**

## **To the Pension Fund Sub-Committee or Pension Board of the Orkney Islands Council Pension Fund**

I am pleased to have the opportunity to present our external audit plan ahead of the meeting on 29 May 2024 in relation to the audit of the financial statements of Orkney Islands Council Pension Fund, as at and for the year ended 31 March 2024.

This report outlines our risk assessment and planned audit approach. Our planning activities are still ongoing and we will communicate any significant changes to the planned audit approach subsequently.

We provide this report to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

This report is indicative at this stage, as we complete our risk assessment and planned work and sets out our approach to setting materiality and likely audit risks as well as other salient aspects of our approach.

### **The engagement team**

Julie Radcliffe is the engagement lead on the audit. She has more than 20 years of pensions industry experience. Julie shall lead the engagement and is responsible for the audit opinion.

Other key members of the engagement team include Kunal Malhotra as engagement manager. He has more than 10 years of industry experience. Kunal will be responsible for overseeing the delivery of our audit.

Yours sincerely,

Julie Radcliffe  
Engagement Director

# Introduction (continued)

## How we deliver 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 that is also important.

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**.

We depend on well planned timing of our audit work to avoid compromising the quality of the audit. This is also heavily dependent on receiving information from management and those charged with governance in a timely manner. As you are aware, we will not issue our audit opinion until we have completed all relevant procedures, including audit documentation.



# Introduction (continued)

## About this report

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

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

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

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.

## Restrictions on distribution

This report is intended solely for the information of those charged with governance of the Fund and the report is provided on the basis that it should not be distributed to other parties; 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.

## Introduction (continued)

### Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Julie Radcliffe, who is the engagement leader for our services to Orkney Islands Council Pension Fund, telephone 0161 246 4369 or email: [Julie.radcliffe@KPMG.co.uk](mailto:Julie.radcliffe@KPMG.co.uk) who will try to resolve your complaint. If your problem is not resolved, you should contact Tim Cutler, our lead for our work for Audit Scotland, either by writing to him at 1, St Peter's Square, Manchester M2 3AE or by telephoning 0161 246 4774 or email to [tim.cutler@kpmg.co.uk](mailto:tim.cutler@kpmg.co.uk). We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to John Cornett, Audit Scotland, 4<sup>th</sup> Floor, 102 West Port, Edinburgh, EH3 9DN.

## Materiality

Our audit work is planned to detect errors that are material to the year end accounts as a whole. We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

Materiality is set within a range deemed appropriate by the Audit Director – this is typically a percentage of total assets (0.5 - 3.0%) for pension funds. **The materiality levels outlined below is indicative and will be confirmed when we receive the draft financial statements.**

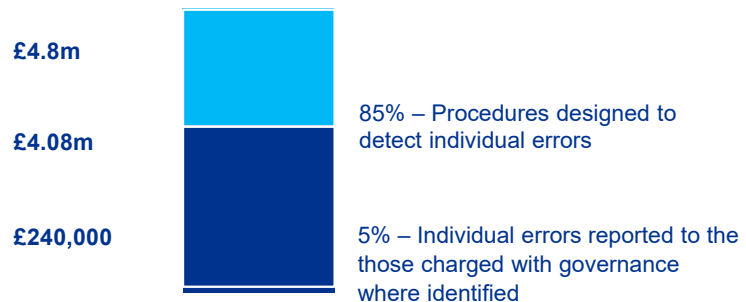
We have set materiality level for the Fund to £4.8m (based on the total assets as at 31 March 2023) which is 1% of estimated total assets, as illustrated below. We have used total assets as the benchmark to determine materiality as this is a key performance indicator used by the user of the Fund’s financial statements. We consider 1% to be the appropriate materiality level, as the Fund is operating in a relatively stable business environment, has a viable sustainable business model and has no external debt.

Materiality will be re-assessed based on the actual results of the Fund for appropriateness before the start of our year end audit.

**Total Assets as at 31 March 2023 £481m**



**Materiality (1% of total assets £4.8m)**



### Reporting to the Pension Fund Sub-Committee

Whilst our audit procedures will be designed to identify misstatements (including disclosure misstatements) which are material to our opinion on the financial statements as a whole, we nevertheless report to those charged with governance any misstatements of lesser amounts to the extent that these are identified by our audit work.

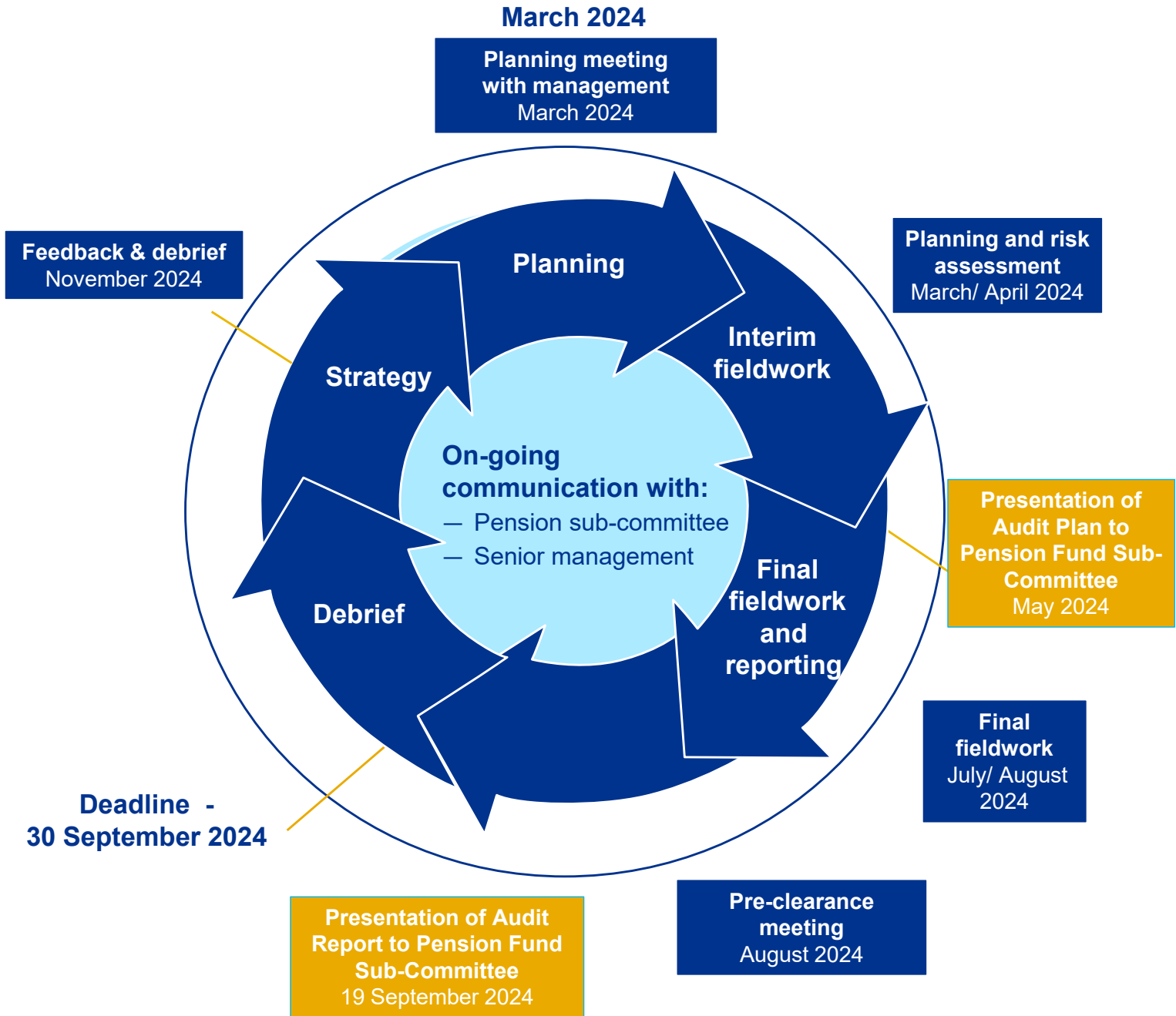
Under ISA 260, we are obliged to report omissions or misstatements (including disclosure misstatements) other than those which are ‘clearly trivial’ to those charged with governance. ISA 260 defines ‘clearly trivial’ as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

To comply with auditing standards, all differences greater than £240,000 are required to be presented to those charged with governance.

We will also have regard to other errors below this amount if evidence of systematic error or if material by nature.

# Audit cycle and timetable

Our audit process operates throughout the year so that we can respond to issues as they arise. We have discussed and agreed the outline audit timetable opposite with Fund management. Progress against the timetable will be monitored continuously by the audit team and reported to Fund management on a regular basis.



- Key Events
- Pension Fund Sub-Committee communications

# Audit summary

## Financial Statement Audit

Our planning and risk assessment is ongoing at the time of preparing this report, and therefore this section of our report sets out the expected audit risks we anticipate to focus our work. This risk assessment is subject to change and we will provide an updated set of risks, should these change significantly.

Our risk assessment draws upon our knowledge of the industry and the wider economic environment in which the Pension Fund operates.

Significant risks	Page
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<b>Other audit risks</b>	
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Cash balances are not completely identified, accurately recorded or do not exist.	16
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## Wider Scope risk assessment

We have commenced our wider scope risk assessment. Audit Scotland planning guidance sets a requirement to focus this risk assessment on the following areas:

- Financial Management
- Financial Sustainability
- Vision, Leadership and Governance
- Use of Resources to Improve Outcomes

From the work performed so far we have not identified any significant risks in relation to these areas. See Wider Scope risk assessment at pages 21-26.

# Audit risks and our audit approach

## Presumed Significant risk

### Management override of controls

#### The risk

- Professional standards require us to communicate the fraud risk from management override of controls as significant.
- Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
- We have not identified any specific additional risks of management override relating to this audit.

#### Planned response

As part of our audit procedures we will gain an understanding of the financial reporting process.

- Our audit methodology incorporates the risk of management override of controls as a default significant risk.
- We will assess accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.
- We will evaluate the selection and application of accounting policies.
- In line with our methodology, we will evaluate the design and implementation of controls over journal entries and post-closing adjustments. We will evaluate the design and implementation of automated controls used in the financial reporting process, where automated controls are in place.
- Assess the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.
- With regards to the financial reporting and journals process, we will perform the following over journal entries and other adjustments:
  - Evaluate the completeness of the population of journal entries.
  - We will determine high risk criteria and select journals based on this criteria for testing.

# Audit risks and our audit approach

## Other audit risks

Level 1, 2 and 3 investments are not complete, do not exist or are not accurately recorded

### The risk

Investments are held to pay benefits of the Orkney Islands Pension Fund. They are held with 4 investment managers across a number of asset classes. The investments are material to the financial statements and therefore there is a risk of material misstatement.

Investments are held to pay benefits of the Orkney Islands Pension Fund. They are held with 4 investment managers across a number of asset classes. The investments are material to the financial statements (99.99% of the Statement of Net Assets as at 31 March 2023) and therefore there is a risk of material misstatement.

There is a risk of material misstatement relating to completeness, existence and accuracy as there has been a number of investment transitions in the year between investment managers.

### Planned response

- As part of our audit procedures we will gain an understanding of the processes over the completeness, existence and accuracy of Level 1, 2 and 3 investments. This will include gaining 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 (where available).
- We will obtain direct confirmations from custodian and all investment managers to vouch the holdings and valuation of assets at the year end.
- We will vouch purchases and sales to investment manager and/or custodian reports.
- We will recalculate change in market value and compare this to the overall investment return stated in the Pension Fund Sub-Committee's report for consistency with the amounts reported in the financial statements. We will investigate any material deviations.

# Audit risks and our audit approach

## Other audit risks

### Valuation of Level 1, 2 and 3 investments is misstated

#### The risk

Investments are held to pay benefits of the Orkney Islands Pension Fund. They are held with 4 investment managers across a number of asset classes. The investments are material to the financial statements (99.99% of the Statement of Net Assets as at 31 March 2023) and therefore there is a risk of material misstatement.

There is an elevated risk of material misstatement relating to fair values of Level 3 pooled investments, due to the estimation uncertainty resulting from irregular pricing of these assets, the illiquid underlying assets, current economic conditions, and entity-specific factors.

#### Planned response

As part of our audit procedures we will gain an understanding of the processes over the valuation of Level 1, 2 and 3 investments. This will include gaining 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 over valuation (where available).

We will obtain direct confirmations from custodian and all investment managers to vouch the holdings and valuation of assets at the year end.

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

#### Segregated financial instruments

Our in-house investment team, iRADAR, will be continue to be engaged to independently re-value 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.



# Audit risks and our audit approach

## Other audit risks

### Valuation of Level 1, 2 and 3 investments is misstated (Cont.)

#### Planned response (Cont.)

##### Pooled Investment Vehicles (Level 1 and 2)

We will continue engaging our in-house investment valuation team, iRADAR, to re-calculate the value of level 1 and 2 pooled investment vehicles, who will use published pricing at the year.

##### Pooled Investment Vehicles (Level 3)

For each Level 3 pooled investment vehicle investment manager, as part of our audit procedures we assess the competency of the investment manager and their work for use as audit evidence;

We will obtain the unaudited Net Asset Value ('NAV') Statement at (or closest to) the measurement date and vouch the valuation to this. We will further assess the reliability of the NAV statement by:

- Obtaining and inspecting the latest audited financial statements for the underlying funds where available;
- Inspecting the audit report to confirm that it is unqualified and that the audit has been carried out by a reputable audit firm; and
- Comparing 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 will agree them to unaudited pricing information at that date and reconcile significant movements to the Fund year end date agreeing movements to [quarterly NAV/transaction statements].

# Audit risks and our audit approach

## Other audit risks (cont.)

Contributions into the Fund are not completely identified and recorded, do not exist or are not in compliance with the Regulations and the Fund's Rates and Adjustments Schedule

### The risk

- Contributions into the Fund are not completely identified and recorded, do not exist or are not in compliance with the Regulations and the Fund's Rates and Adjustments Schedule.
- 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. This revenue is recognized based on specific instructions as set out in the appropriate schedule(s). There are no subjective issues concerning when contributions need to be recognized. Amounts involved cannot easily be manipulated through accounting policies, issue of credit notes, timing or other policies. There is little incentive for the Fund management 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 will gain an understanding of the processes over the contribution payment arrangements between the admitted and schedule bodies and administering authority. As part of risk assessment procedures, we will carry out re-performance checks for a selection of members on normal employee and employer contributions by reference to their pensionable salary and rates.

Our audit procedures over contributions will include:

- Inspecting that deficit funding contributions are received into the Fund in accordance with the Fund's rates and adjustments schedule;
- For a risk based sample of admitted bodies we will inspect whether contributions are received into the Fund on a timely basis under the requirements through vouching contributions received to bank statements;

# Audit risks and our audit approach

## Other audit risks (cont.)

Contributions into the Fund are not completely identified and recorded, do not exist or are not in compliance with the Regulations and the Fund's Rates and Adjustments Schedule (cont.)

### Planned response (cont.)

- Develop 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 and compare these to actual employer and employee contributions received in the year;
- Vouch that there are 12 months receipt. in the year and assessing the trend of such receipts; and
- Agreeing 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 major employer; the Scheduled Body.

# Audit risks and our audit approach

## Other audit risks (cont.)

Cash balances are not completely identified, accurately recorded or do not exist

### The risk

- The balance of cash and cash equivalents is usually material.
- The majority of the Fund's transactions affect the cash balance it is therefore considered to be material by nature.

### Planned response

Our audit will include:

- Obtain the bank confirmation directly from the bank.
- Inspect and vouch the bank confirmation received directly from the bank to the audited Pension Fund balances within the bank reconciliation provided by the administrator.
- Obtain the bank reconciliation (where there are reconciling items) and vouch any significant reconciling items to supporting documentation.

# Audit risks and our audit approach

## Other audit risks (cont.)

Benefits and payments to and on account of leavers that have fallen due are not completely identified, do not exist or are not accurately recorded

### The risk

- Benefits and payments to and on account of leavers that have fallen due are not completely identified, do not exist or are not accurately recorded.
- Pension payroll is usually material in size to the financial statements.
- Benefits and payments to and on account of leavers are made up of a large number of individual member transactions.

### Planned response

As part of our audit procedures we will gain an understanding of the processes over the calculation and authorisation of benefit payments and transfers out and the processing of the pensioner payroll, including the annual pension increase.

#### Our audit procedures over pension payments will include:

- Develop an expectation of the pensions paid in the year reflecting changes in pensioner members in the year, the annual pension increases in the year and compare these to actual pensions paid in the year;
- Inspect that there are 12 months' of pension payments in the year and assessing the trend of such payments;
- Vouch 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.

#### As other benefit payments and payments to and on account of leavers are not material to financial statements, our audit procedures will include:

- Verifying the consistency of membership movements per the administrator database to payments made per the nominal ledger;
- Evaluation of after date payments to ensure there are no material unrecorded liabilities and to ensure cut off is correct.

# Audit risks and our audit approach

## Other audit risks (cont.)

Benefits and payments to and on account of leavers that have fallen due are not completely identified, do not exist or are not accurately recorded (cont.)

### Planned response (cont.)

**Where the benefit payments and/or payments to and on account of leavers are material in total but not on an individual basis our work will involve selecting a sample of members and performing the following procedures:**

- Vouching documentation from the member file and the resulting benefit payment produced by the administrator to the payment made to the member per the bank statement;
- Confirming that there was evidence of peer review/a check of the calculation by a more senior member of the administration team /calculation checked by the actuary (where applicable);
- Inspecting member correspondence to ensure that the benefit paid was in line with the request of the member; and
- Specifically for transfers out, also inspecting that the actuary had provided approval (where required) and reviewing correspondence to check that the receiving fund was an approved pension fund.

# Audit risks and our audit approach

## Other audit risks (cont.)

The actuarial position of the Fund is not appropriately presented in the financial statements

### The risk

- The actuarial position is recognised but not disclosed in the Notes to accounts.
- The value of the liability is an estimate involving 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.

### Planned response

We will perform the following procedures:

- Evaluate the competency, objectivity of the actuaries to confirm their qualifications and the basis for their calculations;
- Test the data provided to the Fund actuary to use within the calculation of the scheme valuation; and
- Compare the key assumptions applied with those used by the administering authority and inquire of the administering authority audit team if there are any matters arising from their evaluation of the assumptions.

# Other significant matters related to our audit approach

## Additional reporting

- The audit is undertaken to comply with the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003 which places additional responsibilities on auditors, as well as further requirements to report to the Audit Scotland.
- Our audit responsibilities under the Code of Practice in respect of the Pension Fund, are as follows:
  - We read any other information published alongside the Pension Fund's financial statements to check that it is consistent with the Pension Fund financial statements on which we give an opinion and is consistent with our knowledge of the Authority.
  - Other information” relates to statements such as Management Commentary, the Remuneration Report, Annual Governance Statement, Governance Compliance Statement and other reports included in the annual report other than the financial statements and the auditor’s report thereon.
  - For the purposes of our audit “Other information” is covered by ISA (UK) 720 The Auditor’s Responsibilities Relating to Other Information, and as such our responsibilities over the disclosures made are similar to those over the content of the Trustee’s Report.
  - Other information is read and checked for consistency with the financial statements and our knowledge gained throughout the audit process. As auditor, we will look for material inconsistencies, but we will not verify any of the detailed disclosures.
- As part of our procedures on other information, we will obtain and read your pension fund annual report and climate change disclosures. We will consider whether there is a material inconsistency between this information included in the annual report and the financial statements, or with our knowledge obtained in the audit; or whether this information appears to be materially misstated





# Wider Scope

# Wider Scope

Appointed auditors are required to consider the areas defined in the Code of Audit Practice (2021) as wider-scope audit. Auditors should consider these additional requirements when:

- identifying significant audit risks at the planning stage
- reporting the work done to form conclusions on those risks
- making recommendations for improvement and, where appropriate, setting out conclusions on the audited body's performance.

The Code of Audit Practice has set out four areas that constitute the wider scope of public audit in Scotland as below:

- Financial Management – Page 23;
- Financial Sustainability – Page 24;
- Vision, Leadership and Governance – Page 25; and
- Use of Resources to Improve Outcomes – Page 26

We set out below an overview of our approach to wider scope requirements of our annual audit.

## Local Risk Assessment

We are required to consider the arrangements in place for the wider-scope areas when undertaking annual risk assessment with a view to preparing the Annual Audit Plan.

As part of our risk assessment, we have considered the arrangements in place for the wider-scope areas and have summarised the results of our assessment and our planned response on the following pages.

## National Risk Assessment

Guidance may supplement auditors' own local risk assessments where there are particular areas of national or sectoral risk that the Auditor General and Accounts Commission wish auditors to consider. However, there are no such risks specified for 2023/24.

# Wider Scope arrangements

## Financial Management

### Scope

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

### Risk Assessment

As part of previous year audit 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.
- The framework of governance, risk management and control were found to be comprehensive and effective.
- Fund has appropriate and effective financial management arrangements in place.
- A budget monitoring system is in place.
- The Fund relies on the Council's arrangements for the prevention and detection of fraud and corruption.

Based the above and our on our risk assessment work to date, we have not identified any significant risks in relation to financial management.

### Planned Audit Response

We will continue to review the financial management arrangements in place.

# Wider Scope arrangements

## 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.

### Risk Assessment

As part of our previous year audit we noted that the Council has a number of arrangement in place, in relation to financial sustainability, including a medium term financial strategy, monitoring performance against the plan and reserves strategy.

Based on the above and our risk assessment work to date we have not identified any significant risks in relation to financial sustainability.

### Planned Audit Response

We will continue to review the financial sustainability arrangements in place.

# Wider Scope arrangements

## 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.

### Risk Assessment

As part of our previous year audit we noted that:

- Pension Fund has effective strategic planning in place
- Governance arrangements are appropriate and operated effectively.
- Arrangements are in place in relation to security, challenge and transparency

Based on above and our risk assessment work to date we have not identified any significant risk in relation to the Fund's arrangements around vision, leadership and governance dimension of the wider scope audit.

### Planned Audit Response

We will continue to review the arrangements in place in relation to vision, leadership and governance.

# Wider Scope arrangements

## 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.

### Risk Assessment

As part of our prior year audit we noted that:

- The Pension Fund Sub-Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance.
- Monitors administration performance against targets.
- Monitors financial performance against targets and other benchmarks.
- Use advisors in decision making
- Evaluate investment manager performances

Based the above and on our risk assessment work to date we have not identified any significant risk in relation to the Fund's arrangements around use of resources to improve outcomes.

### Planned Audit Response

We will continue to review the relevant arrangements in place including arrangements in place in relation to compliance with the effective of performance reporting requirement as part of the best value audit.



# Appendices

- Appendix 1: Mandatory Communications
- Appendix 2: Audit team and rotation
- Appendix 3: Audit fees
- Appendix 4: Confirmation of Independence
- Appendix 5: Responsibility in relation to Fraud
- Appendix 6: Audit Outputs
- Appendix 7: Audit Scotland code of audit practice –  
responsibility of auditors and management
- Appendix 8: KPMG's Audit Quality
- Appendix 9: ISA (UK) 315 Revised
- Appendix 10: ISA (UK) 240 Revised

# Appendix 1

## Mandatory communications



Type	Statement
Management's responsibilities (and, where appropriate, those charged with governance)	<p>Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error.</p> <p>Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.</p>
Auditor's responsibilities	Our engagement letter issued by Audit Scotland on 18 May 2022 communicates our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
Auditor's responsibilities - Fraud	This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.
Auditor's responsibilities – Other information	Our engagement letter issued by Audit Scotland on 18 May 2022 our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.
Auditor's responsibilities – wider scope	Our wider scope slide on page 21 onward sets out our responsibilities for reporting on the Board's arrangements for the 4 wider scope areas.
Independence	Our independence confirmation on page 31 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.



# Appendix 2

## Audit team and rotation

Your audit team has been drawn from our specialist pensions audit department and is led by key members of staff who will be supported by auditors and specialists as necessary to complete our work. We also ensure that we consider rotation of your audit partner and firm.

	<p>Julie Radcliffe is the director responsible for our audit. She will lead our audit work, attend the Pension sub-committee and be responsible for the opinions that we issue.</p>
	<p>Kunal Malhotra is the manager responsible for our audit. He will be responsible for managing the day-to-day coordination and delivery of the audit, liaising with management and supervising the work of the audit team.</p>

### We include in our team:

Our iRADAR team, will review the valuation of the level 1 and 2 PIVs investments to identify any potential material pricing issues.

Other specialists in the areas of direct and indirect tax, actuarial and the valuation of infrastructure funds, private equity and property will be on hand for advice as and when required.

To comply with professional standard we need to ensure that you appropriately rotate your external audit partner. There are no other members of your team which we will need to consider this requirement for:



This will be Julie's 2nd year as engagement lead. She can therefore complete a further 3 years before rotation.

# Appendix 3

## Audit Fees

The following table summarises the proposed fee (subject to agreement between auditor and audited body).

Orkney Islands Council Pension Fund	Inc VAT 2023/24	Inc VAT 2022/23
Auditor Remuneration	43,360	40,910
Pooled Costs	1,580	-
Audit Support	-	1,550
Sectoral Cap Adjustment	-18,590	-17,600
<b>TOTAL Fees</b>	<b>26,350</b>	<b>24,860</b>

### Basis of fee information

In line with our standard terms and conditions the fee is based on the following assumptions:

- The Fund's audit evidence files are completed to an appropriate standard (we will liaise with management separately on this);
- Draft statutory accounts are presented to us for audit subject to audit adjustments;
- There will be no more than 3 sets of draft financial statements presented to us for review;
- Supporting schedules to figures in the accounts are supplied;
- We will attend no more than 2 Pension Fund Sub Committee meetings in the year; one to present our audit strategy memo and another to present the final audit report
- A trial balance together with reconciled control accounts are presented to us;
- All deadlines agreed with us are met;
- We find no weaknesses in controls that cause us to significantly extend procedures beyond those planned;
- Management will be available to us as necessary throughout the audit process; and
- There will be no changes in deadlines or reporting requirements.
- The fee noted above includes VAT but do not include disbursements.

We will provide a list of schedules to be prepared by management stating the due dates together with pro-forms as necessary. Our ability to deliver the services outlined to the agreed timetable and fee will depend on these schedules being available on the due dates in the agreed form and content. If there are any variations to the above plan, we will discuss them with you and agree any additional fees before costs are incurred wherever possible.

### Billing arrangements

Fees will be billed in accordance with a billing schedule agreed with the PSAA.



# 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 Pension Fund Sub-committee and Pension Board

### **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.

# Appendix 4

## Confirmation of Independence (continued)

### Application of the FRC Ethical Standard 2019

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

AGN 01 states that when the auditor provides non-audit services, the total fees for such services to the audited entity and its controlled entities in any one year should not exceed 70% of the total fee for all audit work carried out in respect of the audited entity and its controlled entities for that year.

We confirm that as at 15 March 2020 we were not providing any non-audit or additional services that required to be grandfathered.

### Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Pension Fund Sub-Committee and Pension Board.

### Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, 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 Pension Fund Sub-Committee and Pension Board 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



# Appendix 5

## Responsibility in relation to fraud

We are required to consider fraud and the impact that this has on our audit approach. We will update our risk assessment throughout the audit process and adapt our approach accordingly.

### Management responsibilities

Adopt sound accounting policies.  
With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.  
Establish proper tone/culture/ethics.  
Require periodic confirmation by employees of their responsibilities.  
Take appropriate action in response to actual, suspected or alleged fraud.  
Disclose to Pension Fund Sub-Committee and auditors:

- Any significant deficiencies in internal controls; and
- Any fraud involving those with a significant role in internal controls

### KPMG's response to identified fraud risk factors

Accounting policy assessment.  
Evaluate design of mitigating controls.  
Test effectiveness of controls.  
Address management override of controls.  
Perform substantive audit procedures.  
Evaluate all audit evidence.  
Communicate to Pension Fund Sub-Committee and management.

### KPMG's identification of fraud risk factors

Review of accounting policies.  
Results of analytical procedures.  
Procedures to identify fraud risk factors.  
Discussion amongst engagement personnel.  
Enquiries of management, Pension Fund Sub-Committee, and others.  
Evaluate broad programmes and controls that prevent, deter, and detect fraud.

### KPMG's identified fraud risk factors

, Whilst we consider the risk of fraud at the financial statement level to be low for the Board, we will remain alert to the following areas throughout the year and adapt our audit approach accordingly:

- , Cash;
- , Procurement;
- , Management control override; and
- , Assessment of the impact of identified fraud.

# Appendix 6

## Audit Outputs

Output	Description	Report date
<b>Annual Audit Plan</b>	Our strategy for the external audit of the Board including significant risk and other audit areas.	By 29 May 2024
<b>Annual audit report</b>	We summarise our findings from our work during the year to the Pension Fund Sub Committee.	19 September 2024

# Appendix 7

## Audit Scotland code of audit practice – responsibility of auditors and management

### Responsibilities of management

#### Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- , preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- , maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- , ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- , maintaining proper accounting records; and
- , preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

# Appendix 7

## Audit Scotland code of audit practice – responsibility of auditors and management

### Responsibilities of management

#### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

#### Corporate governance arrangements

Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Pension Fund Sub-Committees or equivalent) in monitoring these arrangements.

#### Financial position

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- , such financial monitoring and reporting arrangements as may be specified;
- , compliance with any statutory financial requirements and achievement of financial targets;
- , balances and reserves, including strategies about levels and their future use;
- , how they plan to deal with uncertainty in the medium and longer term; and
- , the impact of planned future policies and foreseeable developments on their financial position.

#### Best Value, use of resources and performance

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.



# Appendix 7

## Audit Scotland code of audit practice – responsibility of auditors and management

### Responsibilities of auditors

#### Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- , undertake statutory duties, and comply with professional engagement and ethical standards;
- , provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- , review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- , notify the Auditor General when circumstances indicate that a statutory report may be required;
- , participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- , demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  - , effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  - , suitability and effectiveness of corporate governance arrangements; and
  - , financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

# Appendix 7

## Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

<b>Responsibilities of auditors</b>
<b>General principles</b>
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
<b>Independent</b>
<p>When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.</p> <p>Our independence confirmation letter (<b>Appendix 4</b>) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.</p> <p>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 Director and audit staff is not impaired.</p>
<b>Proportionate and risk based</b>
Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self - evaluation evidence when assessing and identifying audit risk.
<b>Quality focused</b>
Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

# Appendix 7

## Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

<b>Responsibilities of auditors</b>
<b>Coordinated and integrated</b>
It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.
<b>Public focussed</b>
The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm's-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.
<b>Transparent</b>
Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.
<b>Adds value</b>
It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement where significant risks are identified.

# Appendix 8

## KPMG's 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. To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

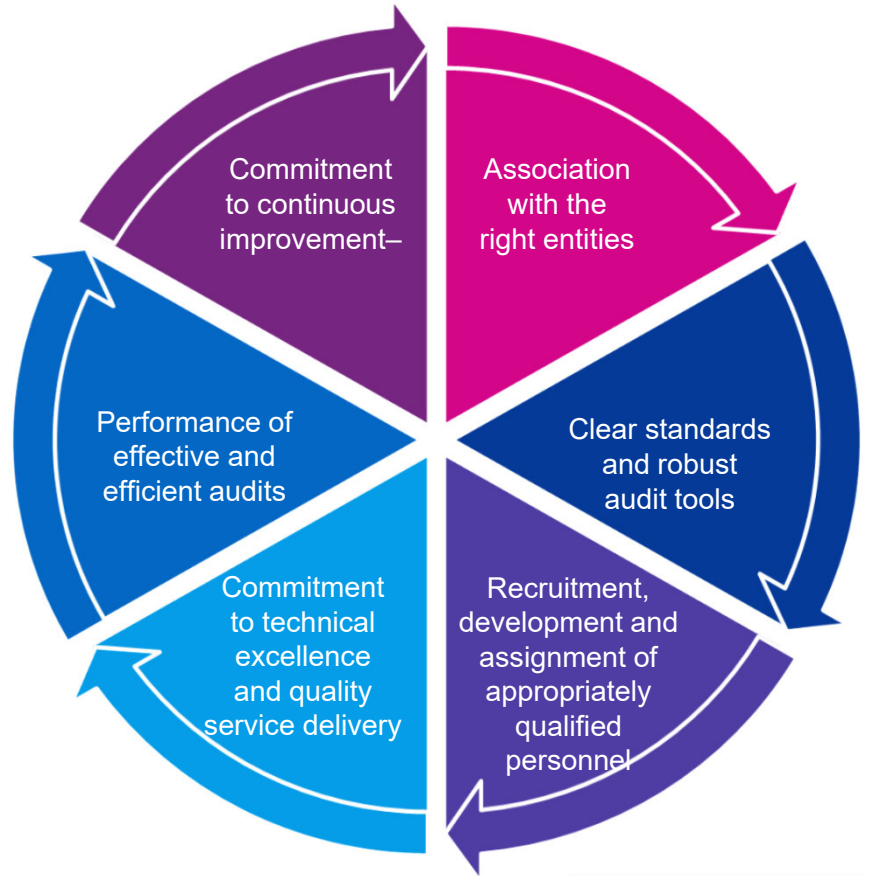
- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

- Select entities within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists



# Appendix 9

## 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.

What impact did the revision have on audited entities?

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 result in additional audit awareness and therefore clear and impactful communication to those charged with governance in relation to (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.

### Implementing year 1 findings into the subsequent audit plan

Entering the second year of the standard, the auditors will have demonstrated, and communicated their enhanced insight into their understanding of your wider control environment, notably within the area of IT.

In year 2 the audit team will apply their enhanced learning and insight into providing a targeted audit approach reflective of the specific scenarios of each Pension Fund's audit.

A key area of focus for the auditor will be understanding how the Pension Fund responded to the observations communicated to those charged with governance in the prior period.

# Appendix 9

## ISA (UK) 315 Revised: Overview (cont.)

### Summary (cont.)

Where an Pension Fund has responded to those observations a re-evaluation of the control environment will establish if the responses by Pension Fund management have been proportionate and successful in their implementation.

Where no response to the observations has been applied by Pension Fund, or the auditor deems the remediation has not been effective, the audit team will understand the context and respond with proportionate application of professional scepticism in planning and performance of the subsequent audit procedures.

What will this mean for our on-going audits?

To meet the on-going requirements of the standard, auditors will each year continue to focus on risk assessment process, including the detailed consideration of the IT environment.

Subsequent year auditor observations on whether Pension Fund actions to address any control observations are proportionate and have been successfully implemented will represent an on-going audit deliverable.

Each year the impact of the on-going standard on your audit will be dependent on a combination of prior period observations, changes in the Pension Fund control environment and developments during the period. This on-going focus is likely to result in the continuation of enhanced risk assessment procedures and appropriate involvement of technical specialists (particularly IT Audit professionals) in our audits which will, in turn, influence auditor remuneration.

# Appendix 9

## ISA (UK) 315 Revised: Summary of key changes (cont.)



Area	Impact on audit effort	Summary of changes and impact
Increased professional scepticism		<p>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.</p>
Understanding the entity		<p>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.</p>
Understanding internal control		<p>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.</p>
IT systems and communication		<p>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.</p>
Control activities		<p>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.</p>
Identifying and assessing risks		<p>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.</p>
Control risk		<p>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.</p>
Stand-back assessment		<p>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.</p>

# Appendix 10



## 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
<p>Risk assessment procedures and related activities</p>	<p>[1] Increased focus on applying professional scepticism – the key areas affected are:</p> <ul style="list-style-type: none"> <li>— the need for auditors not to bias their approach towards obtaining evidence that is corroborative in nature or excluding contradictory evidence,</li> <li>— remaining alert for indications of inauthenticity in documents and records, and</li> <li>— investigating inconsistent or implausible responses to inquiries performed.</li> </ul> <p>[2] Requirements to perform inquiries with individuals at the entity are expanded to include, amongst others, those who deal with allegations of fraud.</p> <p>[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.</p>	
<p>Internal discussions and challenge</p>	<p>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.</p>	





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