

# Orkney Islands Council Pension Fund -

2017/18 Annual Audit Report



 AUDIT SCOTLAND

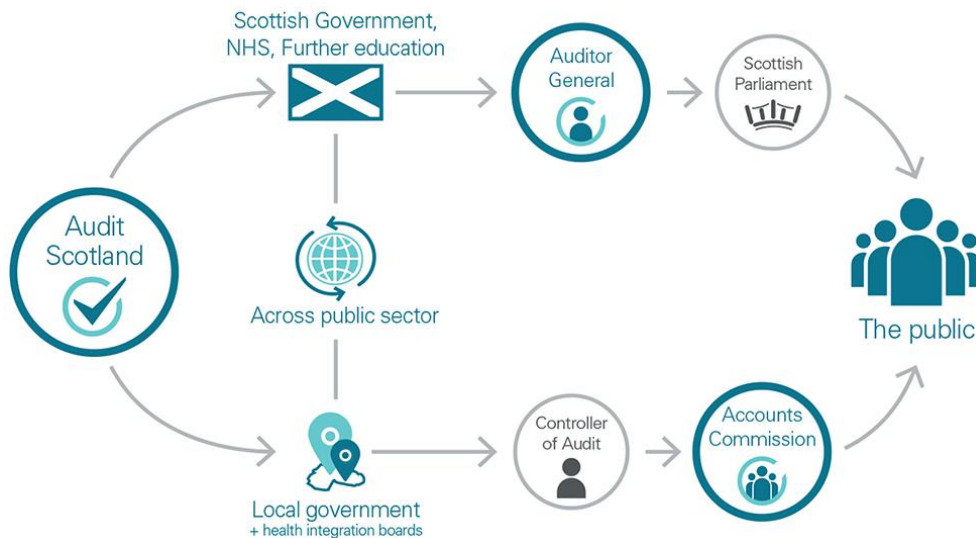
To Members of the Orkney Islands Council Pension Fund Sub-Committee and the Controller of Audit

19 September 2018

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## 2017/18 annual report and accounts

- 1 In our opinion Orkney Islands Council Pension Fund's financial statements give a true and fair view and were properly prepared.
- 2 The management commentary, annual governance statement and governance compliance statement are all consistent with the financial statements and have been properly prepared.

## Financial management

- 3 Orkney Islands Council Pension Fund (the pension fund) has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.
- 4 The pension fund maintained its funding level above 100% for 2017/18. Orkney has the highest funding level relative to other pension funds in 2017/18.

## Financial sustainability

- 5 Following the triennial valuation process, contribution rates will reduce from 19.2% in 2017/18 to 18.2% during 2018/19, with further reductions to 17.6% and 17.0% in 2019/20 and 2020/21 respectively.
- 6 The number of active members continues to be more than the number of pensioners.

## Governance and transparency

- 7 The pension fund has effective governance arrangements in place that support scrutiny of decisions made by the pension fund sub-committee.
- 8 Decisions are transparent with committee papers and detailed minutes of meetings of the pension fund sub-committee available on Orkney Islands Council's website.

## Value for money

- 9 The pension fund's investment performance is subject to regular review and scrutiny by the pension fund sub-committee.
- 10 The pension fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

# Introduction

1. This report is a summary of our findings arising from the 2017/18 audit of Orkney Islands Council Pension Fund (the pension fund).
2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2018 meeting of the pension fund sub-committee. This report summarises our work as follows:
  - an audit of the pension fund's annual accounts; and
  - consideration of the wider dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

3. Orkney Islands Council is the administering authority for the pension fund. The Council delegates this responsibility to the pension fund sub-committee. The pension fund sub-committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The pension fund sub-committee is also required to review the effectiveness of internal control arrangements and approve the annual accounts.
4. Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice 2016](#), and supporting guidance, and are guided by the auditing profession's ethical guidance.
5. As public-sector auditors we give independent opinions on the annual accounts. We also review and provide conclusions on the effectiveness of the pension

fund's arrangements for financial management; financial sustainability; governance and transparency; and value for money.

6. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).
7. This report raises matters from the audit of the annual accounts, risks and control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.
8. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.
9. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2017/18 audit fee of £19,970 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could comprise our objectivity and independence.

### **Adding value through the audit**

10. Our aim is to add value by providing insight and foresight, by identifying areas of improvement and by recommending and encouraging good practice. In so doing, we aim to promote improved standards of governance, better management and decision making and more effective use of resources.
11. This report is addressed to both the members of the pension fund sub-committee and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).
12. We would like to thank all management and staff who have been involved in our work for their co-operational and assistance during the audit.

# Part 1

## Audit of 2017/18 annual accounts



### Main judgements

Our audit opinions are all unqualified. These cover the financial statements, the management commentary, the annual governance statement and governance compliance statement.

### Unqualified audit opinions

- 13.** The annual accounts for the year ended 31 March 2018 were approved by the Orkney Islands Council pension fund sub-committee on 19 September 2018. We reported, within our independent auditor's report:
- an unqualified opinion on the financial statements
  - unqualified audit opinions on the management commentary, annual governance statement and governance compliance statement.
- 14.** We have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

The pension fund's annual accounts is the principal means by which the pension fund demonstrates effective stewardship and use of resources to its external stakeholders.

### Submission of annual accounts for audit

- 15.** We received the unaudited annual accounts on 7 June 2018, in line with the audit timetable set out in our 2017/18 Annual Audit Plan.
- 16.** The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team. This helped ensure the final accounts audit process ran smoothly.

### Risks of material misstatement

- 17.** [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. We also include the wider dimension risks, how we addressed these and our conclusions in the appendix.

### Materiality

- 18.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.
- 19.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#) with regards

to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

20. On receipt of the annual report and accounts we reviewed our materiality calculations and these are shown in Exhibit 2.

## Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality	£1.050 million
Performance materiality	£0.525 million
Reporting threshold	£30,000

Source: Based on Orkney Islands Council Pension Fund Accounts 2017/18

## How we evaluate misstatements

21. There were no material adjustments to the financial statements arising from our audit. One immaterial error was identified, which relates to the valuation of fixed interest investments. The fund manager valued a small number of investments which received fixed interest at their value plus the interest due. The interest element is £0.119 million, which is below our materiality level. The correct accounting treatment would be that this interest element would have been accrued as investment income rather than being reflected in the value of managed funds. There would be no overall impact on the net assets of the pension fund.
22. It is our responsibility to request that all misstatements or errors above the reporting threshold are corrected although the final decision on this lies with those charged with governance considering advice from senior officers and materiality. Management do not propose to adjust for the item above as the amounts are not considered material in the context of the financial statements. We agree that these amounts are not material.

## Significant findings from the audit in accordance with ISA 260

23. International Standard on Auditing 260 (UK & Ireland) requires us to communicate significant findings from the audit to those charged with governance. These are summarised below in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in has been included.
24. The findings should include our views about significant qualitative aspects of the pension fund's accounting practices including:

- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded
- The impact on the financial statements of any uncertainties
- The effect of any unusual transactions on the financial statements
- Misstatements in the annual accounts
- Disagreement over any accounting treatment or financial statements disclosure



## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Migration of Altair Pensions System</b></p> <p>At the beginning of the year the pension fund completed its migration of records to Altair.</p> <p>A reconciliation was then carried out by pensions staff to ensure that all records were migrated from the paper records to the Altair system. The reconciliation was completed towards the end of our audit and internal audit were therefore unable to provide assurance that the reconciliation was satisfactory until after we had completed our audit testing. This delayed the completion and conclusion of our audit work.</p>	<p>Internal audit have now concluded that the records were transferred correctly. We have reviewed the work of internal audit and are content to place reliance on it. No further testing is required.</p>

### Follow up of prior year recommendations

- 25.** We have followed up actions previously reported and assessed progress with implementation. These are reported in [Appendix 1](#) and identified by the prefix b/f (brought forward).
- 26.** In total, 5 agreed actions were raised in 2016/17. Of these:
- 4 have been fully implemented
  - 1 has not been actioned due to staff shortages. The outstanding recommendation will be addressed during 2018/19.
- 27.** Overall the pension fund has made good progress in implementing these actions. For the action not yet implemented, a revised response and timescale has been agreed with management, as set out in [Appendix 1](#).

### Other Findings

- 28.** Our audit identified several presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited annual accounts.
- 29.** In particular, the governance statement required a significant number of changes to ensure it provides a clear, understandable and balanced assessment of the performance of the pension fund.

### Pre-audit inspection and objections to the accounts

- 30.** The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The notice for Orkney Islands Council Pension Fund was published on the website of the administering authority (Orkney Islands Council) and complies with the regulations. No objections were received on the pension fund accounts.

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# Part 2

## Financial management

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### Main judgements

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**The pension fund maintained its funding level above 100% for 2017/18. Orkney has the highest funding level relative to other pension funds in 2017/18.**

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**The pension fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.**

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**Our testing of the design and operation of the financial controls over significant risk areas confirmed that controls relating to financial systems and procedures are designed appropriately and operating effectively. We did not identify any significant internal control weaknesses.**

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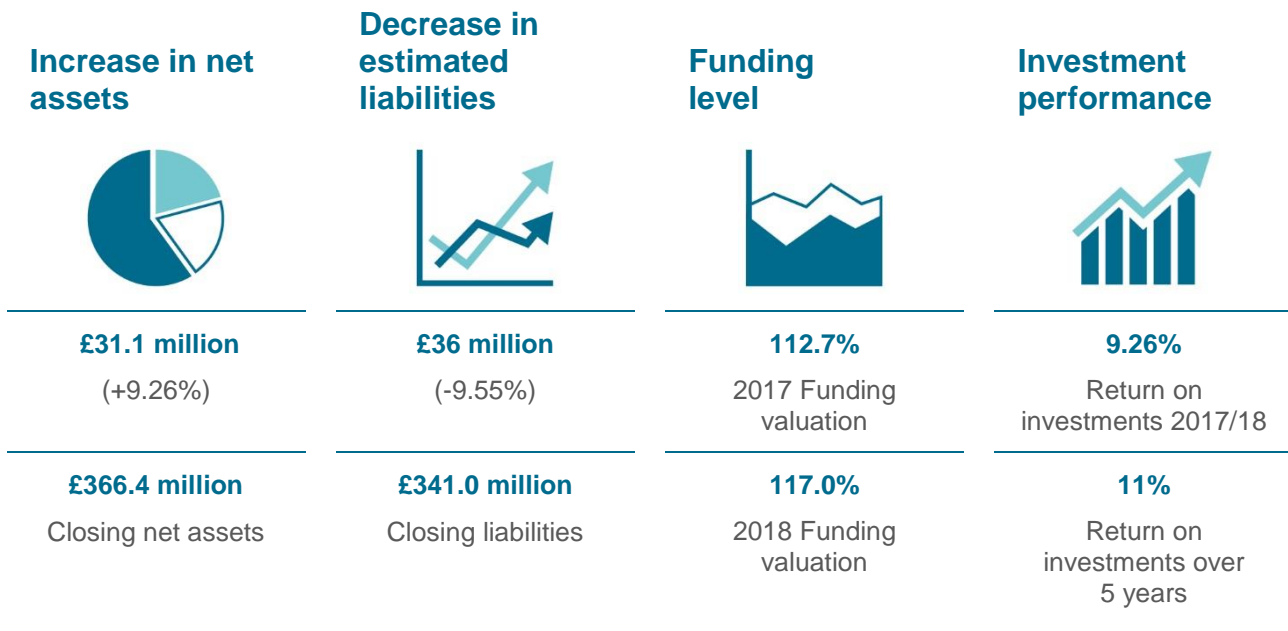
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### Financial performance in 2017/18

- 31.** In line with the Local Government Pension Scheme (Scotland) Regulations 2014, the pension fund's actuary undertakes a funding valuation every three years. The actuarial valuation assesses the health of the fund and provides a check that the funding strategy and assumptions used are appropriate. It also sets the future rates of contributions payable by employers. The most recent full actuarial valuation by the Fund's actuaries Hymans Robertson was to 31 March 2017.
- 32.** This showed that the funding level was 112.7%, down from 114% at the last triennial valuation at 31 March 2014. The fall was mainly attributed to a fall in gilt yields which were largely offset by the significant gains in the value of the fund over the same period. The 2018 valuations increased the funding level to 117%.
- 33.** The pension fund's performance in 2017/18 is summarised in [Exhibit 4](#).

## Exhibit 4

### Assets, liabilities, funding level and investment performance



Source: OICPF 2017/18 audited financial statements and OICPF reports

34. The net assets of the pension fund increased to £366.4 million at 31 March 2018 from £335.3 million at 31 March 2017. This increase of £31.1 million (9.3%) exceeded the target of 2.7% for 2017/18.
35. At the same time the estimated pension liabilities decreased from £377 million at 31 March 2017 to £341 million at 31 March 2018 (£36 million decrease).
36. During 2017/18 the funding level increased to 117.0% at 31 March 2018 from its value of 112.7% last financial year end, calculated on an ongoing funding basis. The pension fund continues to maintain a position above its 100% funding target, being in surplus by £53m at the financial year end (2017: £38m).
37. From our review of unaudited accounts, Orkney has the highest funding level relative to other pension funds in 2017/18.
38. During 2017/18 contributions to the pension fund amounted to some £9.9 million. This was greater than the benefits paid out which totalled £6.8 million. Exhibit 8 (page 16) shows how Orkney compares to the other 11 local government pension funds in terms on contributions received compared to benefits payable.

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

## Financial management arrangements

39. The Head of Finance for Orkney Islands Council is the proper officer responsible for the pension fund, is part of the corporate and senior management teams and reports directly to the Chief Executive.

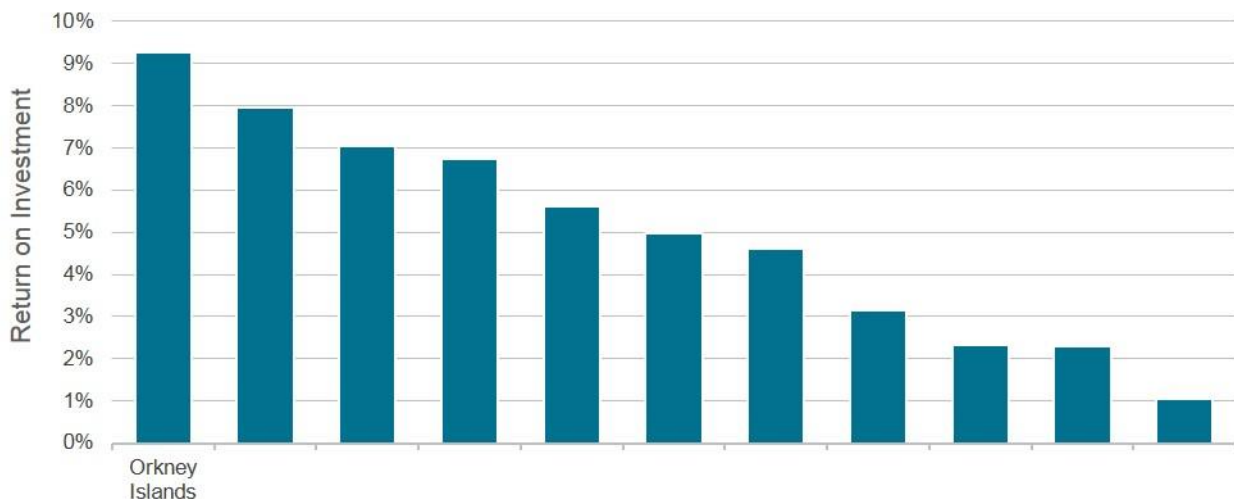
40. The financial regulations of Orkney Islands Council, as administering authority, apply to the pension fund. We consider these to be comprehensive, and current, and promote good financial management.
41. Investment and administration performance reports are submitted to the pension fund sub-committee on a quarterly basis. Reports are comprehensive, and we observed a good level of review and scrutiny by members at the meetings we attended.
42. We have concluded that the financial management arrangements are sufficient to ensure the ongoing success of the pension fund.

## Financial outcomes

43. In 2017/18 returns were down on 2016/17 and there was mixed investment performance across the LGPS pension funds in Scotland, as illustrated in [Exhibit 5](#).

### Exhibit 5

#### LGPS pension funds – Net return on investment 2017/18 (unaudited figures)



Source: 2017/18 LGPS pension fund unaudited financial statements

44. Orkney Islands Council Pension Fund has achieved the highest return on assets across all local government pension funds in Scotland, as it did in 2017/18. However, the relative performance should not be considered without acknowledging that there are different investment strategies.
45. The return on investments was 9.3%, compared to a benchmark of 2.3%. The average return over the past 5 years is 11.1% against a benchmark of 8%.
46. We have concluded that the pension fund's overall performance is good. However, the pension fund sub-committee requires to continually monitor performance as it is unlikely that high performance returns will continue.

## Systems of internal control

47. Our objective is to gain assurance that the pension fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

48. The pension fund uses some of the administering authority's key financial systems in particular the financial ledger and payroll. We obtained confirmation from the external auditors of the Council that there were no significant weaknesses in the internal controls for those systems for 2017/18.
49. Each year, the pension fund receives internal control reports on their investment managers, Baillie Gifford, and on Bank of New York Mellon, for asset services. These are high-level reviews developed under International Standard on Assurance Engagements (ISAE3402), to provide assurance to user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting. We noted that management complete a review of the internal control reports but that neither the reports nor the details of the reviews performed by management are reported to the pension fund sub-committee.
50. During 2017/18 management recorded that systems of internal controls were assessed as operating effectively and no action was required by the pension fund.

Appendix 1 Point 1

51. Following a two-year process, the pension fund completed its migration of records to Altair at the end of March 2017. A reconciliation was then completed by pensions staff to ensure that all records were correctly migrated from the paper records to the Altair system. The reconciliation was reviewed by internal audit who confirmed that all records had been transferred correctly. We reviewed the work of internal audit and were content to place reliance on their findings.
52. We concluded that the controls were operating effectively. No significant control weaknesses were identified which could affect the pension fund's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

# Part 3

## Financial Sustainability



### Main judgement

**Following the triennial valuation process, contribution rates will reduce from 19.2% in 2017/18 to 18.2% during 2018/19, with further reductions to 17.6% and 17.0% in 2019/20 and 2020/21 respectively.**

**There continues to be more active members than pensioners.**

### Funding position and financial planning

- 53.** The March 2017 triennial valuation (paragraph 31) report produced at 31 March 2018 showed that the funding surplus has increased since the last full valuation. Strong asset returns, partially offset against contributions less benefits accruing has improved last year's funding level of 112.7%, to 117.0% at 31 March 2018.
- 54.** Following the triennial valuation process, the actuary recommended that contribution rates reduce from 19.2% in 2017/18 to 18.2% during 2018/2019, with further reductions to 17.6% and 17.0% in 2019/20 and 2020/21 respectively. The pension fund sub-committee at its meeting on 23 May 2018 noted that the Actuary had approved a graduated reduction in the employers' contribution rates expressed as a percentage of pensionable pay. Officers have reviewed and updated the Pension Fund Funding Strategy Statement which the Sub-committee reviewed and approved on 23 May 2018.
- 55.** As identified at Exhibit 8, the pension fund is paying out less in benefits than it receives in contributions from members. This leaves the pension fund in a relatively health position, at least in the short term. It is likely that in the future this will be reversed, which is the case in 5 of the 11 Scottish LGPFs as shown in Exhibit 9. The current position is helped by the increase in members which is shown in Exhibit 7. This also shows that the rate of increase is in decline, while the number of pensioners increases.

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

### Membership levels

- 56.** The pension fund is a multi-employer fund with members from six admitted bodies in addition to members employed by Orkney Islands Council. Orkney Ferries Limited and Pickaquoy Centre Trust members make up 85 per cent of active admitted bodies' members. Given the size and nature of these employers the pension funding risk associated with default is seen as relatively low. The current membership profile is shown at Exhibit 7. The number of active members continues to outweigh the number of pensioners.

## Exhibit 7

### Orkney Islands Council Pension Fund Membership



Source: Orkney Islands Council Pension Fund 2017/18 unaudited financial statements

**57.** Active membership of the pension fund increased slightly by 24 in 2017/18 to 1,966 members at 31 March 2018; over the past 5 years membership has grown by 383 active members, which represents an increase of 24.2%. The impact of auto-enrolment contributed to the increase in members.

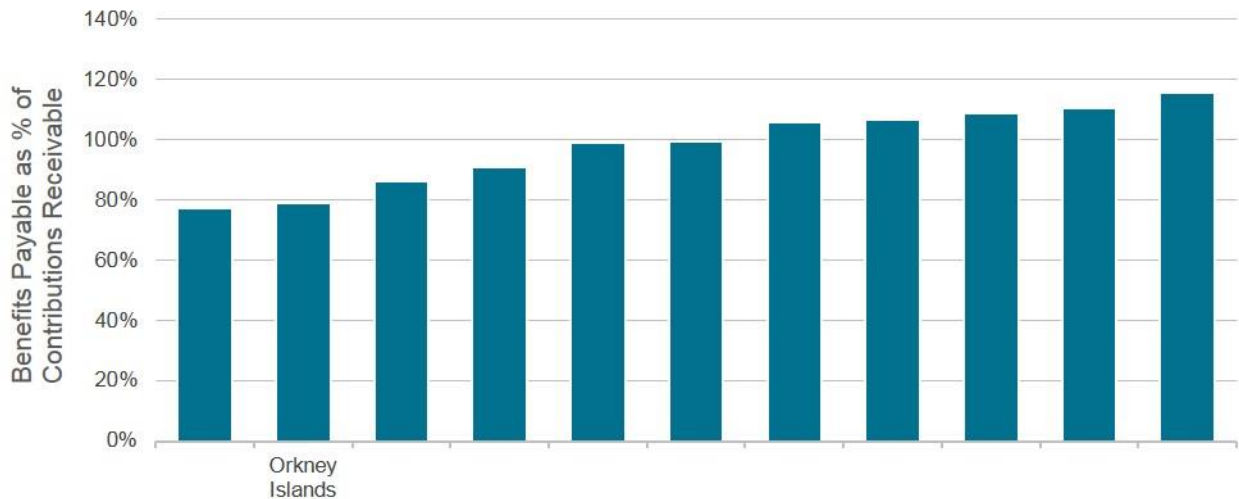
## Contributions

**58.** Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards.

**59.** The pension fund reported a surplus from dealings with members of £2.6 million in 2017/18. This means that member contributions and investment income exceeded pension payments. Exhibit 8 below shows how Orkney Islands Council Pension Fund compares with the other 10 Local Government Pension Funds (LGPF's) in Scotland in terms of contributions receivable and benefits payable. Five of the 11 pay out more than receive. Orkney is in a relatively healthy position in that it does not need to move from capital generating assets to income generating assets.

## Exhibit 8

### Benefits Payable as a proportion of contributions receivable



Source: 2017/18 LGPS pension fund unaudited financial statements

## EU withdrawal

**60.** There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce - the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports.
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

**61.** The pension fund recognises the difficulty of planning for Brexit amid considerable uncertainty. In terms of the market implications for investment performance, the pension fund is taking a diversified, balance approach to mitigate against the risk.



62.

# Part 4

## Governance and transparency



### Main judgements

**The pension fund has effective governance arrangements in place that support scrutiny of decisions made by the pension fund sub-committee.**

**Decisions are transparent with committee papers and detailed minutes of meetings of the pension fund sub-committee available on the Orkney Islands Council's website.**

### Governance arrangements

- 63. Orkney Islands Council is the administering body for the pension fund. The council has delegated responsibility for governance to the pension fund sub-committee.
- 64. Members of the pension fund sub-committee are supported by the pension board. The pension board is responsible for establishing arrangements to ensuring the proper conduct of the affairs of the pension fund in accordance with the law and the requirements of the Pensions Regulator which includes the administration of the pension fund and investments, as well as the responsibility for preparing, publishing and maintaining the funding strategy statement and the statement of investment Policies. The pension fund sub-committee monitors the adequacy and effectiveness of these arrangements.
- 65. From attendance at meetings we found effective scrutiny and challenge of policy and investment decisions, and evidence that pension board and sub-committee members receive appropriate and sufficient training in order to carry out their roles.

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

### Transparency

- 66. Transparency means that the public, in particular members have access to understandable, relevant and timely information about how the pension board and sub-committee are taking decisions and how they are using resources.
- 67. There is evidence from several sources which demonstrate the pension fund's commitment to transparency. For example, the pension fund's annual accounts are available on the Orkney Islands Council website, in addition pension fund sub-committee papers are available on the website in advance of meetings.
- 68. The pension board and pension fund sub-committee meetings are held in public but with commercially sensitive information dealt with in private session, and the minutes of these meetings are publicly available on the council's website.
- 69. The Council has been working to improve communication and Pension Fund Members should expect to receive a pensions newsletter with their annual benefits statements later this year.

70. Overall, we concluded that the pension fund conducts its business in an open and transparent manner.

### **Other aspects of governance**

71. We reviewed various other aspects of governance that apply to the pension fund including standing orders, financial regulations and arrangements for reporting breaches of regulation to the Pensions Regulator.
72. Overall, we concluded that there are open and transparent arrangements in place.

### **Pensions Regulator Public Service Code**

73. The Public-Sector Pensions Act 2013 provided for extended regulatory oversight by the Pensions Regulator. The Pensions Regulator issued a code on the governance and administration of public service pension schemes in January 2015 which funds are expected to comply with. The pension fund participates in an annual "Pensions Regulator: Public Service Governance Survey" and the Pension Fund Annual Report and Accounts 2017/2018 contains a Governance Compliance Statement which sets out the extent to which the Orkney Islands Council Pension Fund governance arrangements comply with best practice. This provided assurance that the pension fund is largely in compliance with the regulations. There were no breaches of the Code that required to be reported to the Pensions Regulator in 2017/18.

### **Risk management**

74. We commented in our Annual Audit Report last year that the risk register had not been updated since March 2016. We are pleased to report that the risk register was reviewed, updated, and presented to the pension fund sub-committee in November 2017.

### **Internal audit**

75. Internal audit provides the pension fund with independent assurance on the pension fund's overall risk management, internal control and corporate governance processes.
76. The internal audit function is carried out by the internal audit section of Orkney Islands Council. We conducted a review of the adequacy of the internal audit function and concluded that it operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
77. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2017/18 we placed formal reliance on internal audit's work in reviewing the reconciliations carried out to ensure that the paper pension records were satisfactorily transferred to the new electronic system, Altair.

### **Management commentary, annual governance statement and governance compliance statement**

78. The applicable legislation and regulations require pension funds to prepare and publish, along with their financial statements, a management commentary, an annual governance statement, and a governance compliance statement that are consistent with the disclosures made in the financial statements. The management commentary should be fair, balanced and understandable and clearly address the longer-term financial sustainability of the body.

79. Based on our knowledge and work performed, we concluded that the management commentary, the updated annual governance statement and the governance compliance statement are consistent with the financial statements.

### **Standards of conduct for prevention and detection of fraud and error**

80. We assessed the pension fund's arrangements for the prevention and detection of fraud. The pension fund relies on the administering body's (Orkney Islands Council) arrangements for the prevention and detection of fraud and corruption. These include Code of Conduct for members and officers, whistleblowing policy and an anti-fraud strategy.
81. We concluded that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2017/18.

### **Cyber security**

82. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017 which requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate. Bodies are encouraged to seek independent assurance of critical technical controls, which in the Scottish Government's view is achieved by obtaining Cyber Essentials or Cyber Essentials Plus accreditation. We note that the administering authority obtained cyber essentials (basic) accreditation in February 2018 and plan to obtain cyber essentials (plus) accreditation in 2019.

# Part 5

## Value for money



### Main judgements

The pension fund's investment performance is subject to regular review and scrutiny by the pension fund sub-committee.

The pension fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

### Investment performance

83. The pension fund sub-committee meets on a quarterly basis. A review of fund managers' performance is a standing item on the committee's agenda. At each meeting, committee members receive a report outlining overall fund performance including an analysis of risks and returns.

### Exhibit 9

#### Pension fund investment performance



Source: Orkney Islands Council Pension Fund Reports

84. Exhibit 9 shows that over the year, the pension fund generated a return of 9.3% against a benchmark of 2.3%. Equity portfolios were the most significant contributor to this increase.
85. Over the medium to longer term the pension fund has outperformed its benchmark over three, five and since inception.
86. Orkney has the highest return on assets across all the LGPS Funds in Scotland in 2017/18. This was also the case in 2016/17. [Exhibit 5](#)

Value for money is concerned with using resources effectively and continually improving services.

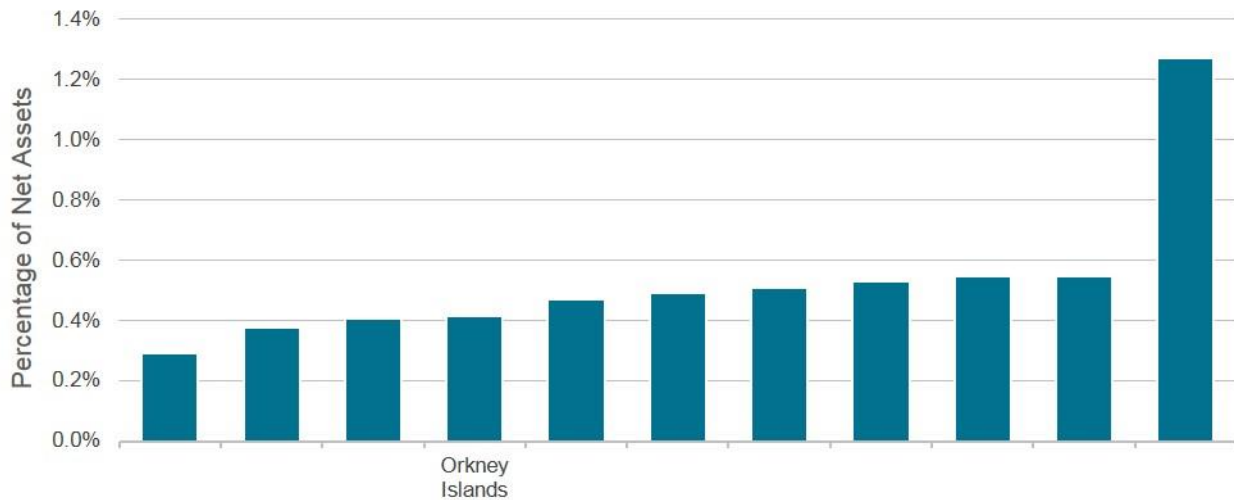
- 87.** Investment return and risk are inextricably linked, and it is not possible for us to give an opinion on the relative performance of the pension fund's investments given the risk exposure of the asset allocation and investments made. However, we are aware that the pension sub-committee is regularly updated with details of how closely aligned the pension fund's investments are with its investment strategy. The pension fund is currently taking steps to realign the portfolio asset allocations with the investment strategy, which have become out of line due to the increase in equity valuations.
- 88.** We concluded that the pension fund has adequate arrangements in place for monitoring investment performance.

## Management expenses

- 89.** 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 the governance fees for actuarial and audit services.
- 90.** CIPFA published revised guidance on LGPS management expenses. This guidance sets out a framework for the reporting of investment management costs and was applied from 2016/17. The new guidance recommends that only expenses that can be directly controlled by the pension fund should be included.
- 91.** Now that the additional information on the cost of LGPS investment management services is available, the pension fund should continue to review the level of management expenses. This includes the development of benchmarking information and in the context of returns achieved, to ensure that value for money is being secured.
- 92.** External investment manager fees are agreed in the respective mandates governing their appointments. These are usually based on the market value of the investments under their management and therefore increase or reduce as the value of these investments changes.
- 93.** Investment management expenses have increased from £0.938 million in 2016/17 to £1.055 million in 2017/18. This is because they are based on the total value of the pension fund, which increased in value in 2017/18.
- 94.** [Exhibit 10](#) shows figures for total management expenses relative to net assets across the Scottish Local Government Pension Funds, with investment management expenses for the Orkney Islands Council Pension Fund highlighted. The pension fund had the fourth lowest percentage in Scotland. However, variances in investment strategies and administrative structures (e.g. in-house staff vs. outsourced services) will impact on the amount of external investment management expertise purchased.

## Exhibit 10

### Investment management expenses



Source: 2017/18 LGPS pension fund unaudited financial statements

**95.** We have concluded that the pension fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses. CIPFA guidance on management expenses has enabled greater transparency in investment management fee information including the development of benchmarking information. Management should continue to make use of the additional information now available on the cost of investment management services to make informed decisions on value for money, as well as the performance of managers.

### Administrative expenses

**96.** The workload of the pension administration section continues to grow primarily due to the introduction of the career average pension scheme (CARE) from 1 April 2015. Other factors impacting on the administration workload include auto enrolment and freedom of choice as well as the transfer of records to Altair during 2017/18.

**97.** Exhibit 11 illustrates good and improving administration performance. In 2017/18, 4 out of 5 of the standards reported improved performance compared to 2016/17.

## Exhibit 11

### Administration Performance

	Performance Standard (days)	Percentage processed within standard 2016/17	Percentage processed within standard 2017/18	Relative performance compared to prior year
Pension estimates	10	30.0%	65.0%	↑
Retirements	5	93.0%	100.0%	↑
Transfers in	10	88.7%	95.6%	↑
Transfers out	10	82.4%	94.7%	↑
Refunds	5	100.0%	93.6%	↓

Source: OICPF Reports

### National performance audit reports

98. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2017/18, we published reports which may be of direct interest to the pension fund. These are outlined in [Appendix 3](#) accompanying this report.
99. Each year Audit Scotland produces a Local Government Overview Report, the report is usually reviewed by Orkney Islands Council. Included within the report is a supplement specifically relating to pension funds. The pension fund sub-committee should review this report annually.

# Appendix 1

## Action plan 2017/18

### 2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Performance management reporting</b></p> <p>Each year, the pension fund receives internal control reports on their investment managers, Baillie Gifford, and on Bank of New York Mellon for asset services. These are high-level reviews developed under International Standard on Assurance Engagements (ISAE3402), to provide assurance to user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting. We noted that management complete a review of the internal control reports and record their observations but that neither the reports nor the details of reviews performed by management are reported to the pension fund sub-committee.</p>	<p>To enhance performance management reporting, details of the investment manager internal control reports should be provided to members of the pension fund sub-committee along with any observations raised by management.</p> <p><a href="#">Paragraph 48</a></p>	<p>The Finance Service has introduced a documented review process for all internal control reports that includes a process for reporting any significant issues to members of the Pension Board and Sub-committee. The internal control reports are lengthy and technical documents and are also available to the pension fund sub-committee on request.</p> <p>Head of Finance</p> <p>Agreed date: With immediate effect</p>

### Follow up of prior year recommendations

b/f	<p><b>1. Migration of Altair Pension System</b></p> <p>The pace of migration to the Altair system is slow, with only around 75% of membership now transferred since 2012/13.</p>	<p>The process to transfer records has been disappointingly slow with very little automation possible meaning that this has been a huge manual exercise. We will arrange for some additional temporary staff resource to assist with the transfer of the remaining records. The transfer of</p>	<p>This migration of records was completed at the end of March 2017.</p>
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No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>There is a risk that slow migration to the new system increases the inefficiency of service provided to members.</p>	<p>the remaining records should be complete by December 2017. Head of Finance December 2017</p>	
b/f	<p><b>2. Local Code Good Governance Arrangements</b></p> <p>The requirement in 2016/17, is for the pension fund to publicly report on their compliance with their Local Code was not completed.</p> <p>There is a risk that the pension fund did not adopt the requirements of the Delivering Good Governance Framework in 2016/17.</p>	<p>We will carry out an exercise to review our compliance with the Local Code during 2017/18 and report on this in the 2017/18 financial statements. Head of Finance March 2018</p>	<p>A review was carried out in 2017/18.</p>
b/f	<p><b>3. Internal Control Procedures</b></p> <p>During 2016/17, the Altair ICT system was used to record member entitlements and to perform some calculations.</p> <p>With the new system and more staff now working on pensions there is an opportunity to develop new internal controls procedures for the Altair system to reduce the risks of errors and provide the opportunity for independent checks by more staff.</p>	<p>An authorisation and approvals hierarchy will be developed during 2017/18 for the Altair system so that the segregation of duties can be followed and evidenced on working papers. The extent to which segregation can be practically implemented is however restricted due to the very small size of the pension team. Head of Finance March 2018</p>	<p>Due to staff shortages this review has not been carried out.</p>
b/f	<p><b>4. Risk Register</b></p> <p>The risk register was last reviewed and updated by the pension fund sub-committee in March 2016.</p> <p>There is a risk that the pension fund may not identify any new risks or actions to address the current risks.</p>	<p>The updated risk register will be presented to the pension fund sub-committee by December 2017. Head of Finance December 2017</p>	<p>A revised risk register was reported to the pensions fund sub-committee in November 2017.</p>
b/f	<p><b>5. Member Training</b></p>	<p>The pension fund sub-committee adopted a training policy statement</p>	<p>Revised training policy and training register was agreed at the February</p>



**No.**    **Issue/risk**



**Recommendation**



**Agreed  
management  
action/timing**

A good induction training programme was provided to all members following the local government elections. However, a training policy and programme require to be developed. Ongoing training and support is important to strengthen the level of scrutiny.

There is a risk that members do not have retention of knowledge and understanding to support their role.

in 2015 in line with the Code of Practice on Public Sector Pensions Finance Knowledge and Skills. A training register will be developed to assist committee and board members in meeting the knowledge and skills requirements set out in the CIPFA Pensions Finance Knowledge and Skills Frameworks.  
Head of Finance

March 2018

2018 Pension Fund Sub Committee.

# Appendix 2

## Significant audit risks identified during planning












The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>Based on our testing, we found no evidence of bias in accounting estimates, no evidence of transactions out with the scope of the pension fund and no evidence to suggest that management were overriding controls.</p>
<p><b>2 Risk of fraud over income and expenditure</b></p> <p>ISA 240 presumes a risk of fraud over income; this is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and the Financial Reporting Council's Practice Note 10 (revised).</p> <p>The Orkney Islands Council Pension Fund receives a significant amount of investment income from third party sources. This presents a risk due to the extent and complexity of income.</p>	<p>Substantive testing of expenditure.</p>	<p>Interim controls testing results were satisfactory.</p> <p>We carried out 'reliance on a management expert' work on the pension fund manager and the actuary and concluded that we could place reliance on third parties.</p> <p>We found no evidence of fraud over income.</p>
<p><b>3 Changes to financial reporting</b></p> <p>Pension funds will be required to disclose information on investment management transaction costs, including the amount for each asset class, their nature, and how they arise</p>	<p>Communication of technical changes with officers.</p> <p>Review disclosures as part of our financial statements audit.</p>	<p>We reviewed the disclosures made and verified to supporting documentation.</p> <p>No issues were identified.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>for different types of investment.</p> <p>It is essential that the pension fund is in a position to capture these costs.</p>		
<p><b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b></p>		
<p><b>4 Governance Statement assurances</b></p> <p>Internal audit have planned limited reviews of key financial systems during 2017/18.</p> <p>There is a risk that the pension fund will have insufficient assurances for the governance statement for 2017/18.</p>	<p>Liaise with Internal Audit early in the year.</p>	<p>Internal Audit performed a review of the reconciliation of data transferred to the new Altair system. We were content to place reliance on their work.</p>
<p><b>5 Internal Control Procedures</b></p> <p>During 2017/18, the pension fund have migrated all records to the Altair ICT system which is used to record member entitlements and to perform some calculations.</p> <p>With the new system and more staff now working on pensions there is an opportunity to develop new internal controls procedures for the Altair system to reduce the risks of errors and provide the opportunity for independent checks by more staff.</p>	<p>Review the pension funds authorisation and approvals hierarchy.</p>	<p>This recommendation is carried forward to 2018/19.</p>
<p><b>6 Local Code Good Governance Arrangements</b></p> <p>The pension fund should review its compliance of its local code with the Delivering Good Governance Framework.</p>	<p>Review the pension funds compliance exercise.</p>	<p>A review was carried out and reported to the February 2018 Pension Fund Sub Committee. No exceptions were noted.</p>

# Appendix 3

## Summary of national performance reports 2017/18

		 <b>2017/18 Reports</b>	
		Apr	
		May	
Common Agricultural Policy Futures programme: further update		<b>Jun</b>	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		<b>Aug</b>	
Equal pay in Scottish councils		<b>Sept</b>	
Transport Scotland's ferry services		<b>Oct</b>	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		<b>Nov</b>	
		Dec	
		Jan	
Early learning and childcare		<b>Feb</b>	
Managing the implementation of the Scotland Acts		<b>Mar</b>	

### Reports relevant to local government pension funds

[Local Government in Scotland: financial overview 2016/17 - LGPS Supplement](#) – November 2017

# Orkney Islands Council Pension Fund - 2017/18 Annual Audit Report

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