

Orkney Islands Council Pension Fund

2019/20 Annual Audit Report



 AUDIT SCOTLAND

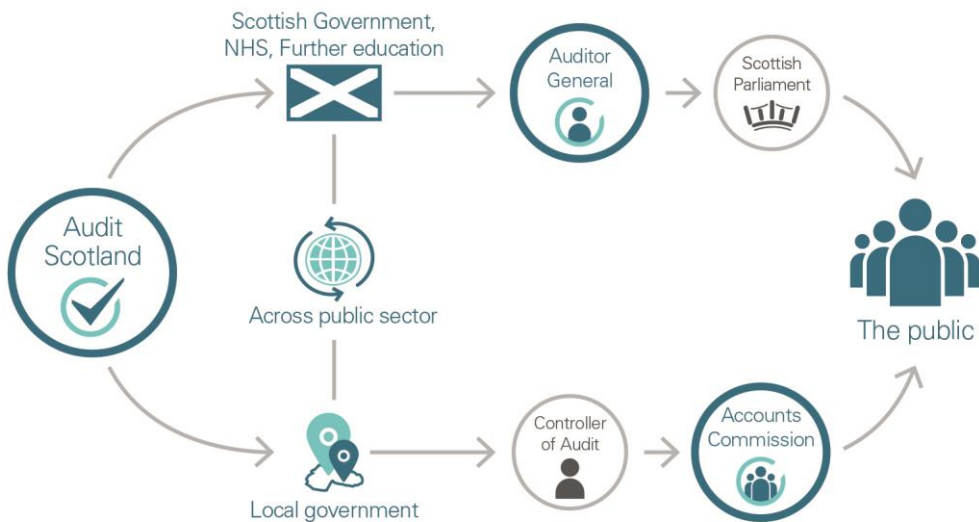
To Members of the Orkney Islands Council Pension Fund Sub-Committee and the Controller of Audit

26 October 2020

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

2019/20 annual accounts

- 1 Orkney Islands Council Pension Fund's financial statements give a true and fair view of the financial transactions of the Fund during the year ended 31 March 2020 and of the amount and disposition at that date of its assets and liabilities.
- 2 The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.

Financial management

- 3 The annual performance of the Fund was significantly impacted by Covid-19. At 31 December 2019 the value of the Fund's assets was £432.6 million but by the end of March the value fell to £376.6 million as a result of Covid-19.
- 4 Despite the poor annual performance of the Fund, the liabilities remained fully funded with an estimated funding level of 104.6 per cent.
- 5 The Fund has appropriate and effective arrangements in place for financial management.

Financial sustainability

- 6 The Fund continued to receive sufficient contributions in year to cover payments made to pensioners.
- 7 The Fund's three year funding and investment strategy will be reviewed following the next full triennial valuation, due to be completed by 31 March 2021. This will determine the level of employer contribution rates from 2021/22 onwards.

Governance and transparency

- 8 The Fund has effective governance arrangements that support scrutiny by the Pension Fund Sub-Committee.
- 9 The Covid-19 pandemic had a limited impact on governance arrangements at the Fund. We consider the changes made to be proportionate and appropriate.

Value for money

- 10 The impact of Covid-19 on global markets reduced annual returns significantly but investment performance continues to outperform medium and longer term benchmarks.
- 11 The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management.

Introduction

1. This report is a summary of our findings arising from the 2019/20 audit of Orkney Islands Council Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2020 meeting of the Pension Fund Sub-Committee. This report comprises:

- an audit of the Fund's annual accounts
- 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. The main elements of our audit work in 2019/20 have been:

- an audit of the Fund's 2019/20 annual accounts including the issue of an independent auditor's report setting out our opinions
- a review of the Fund's main financial systems
- consideration of the four audit dimensions.

4. Subsequent to the publication of the Annual Audit Plan, in common with all public bodies, the Fund has been impacted by the global coronavirus pandemic. Our planned audit work has been adapted for new emerging risks as they relate to the audit of the financial statements and the wider dimensions of audit. The audit of the financial statements was conducted remotely.

Added Value

5. We add value to the Fund through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

6. Taking this together, we aim to help the Fund promote improved standards of governance, better management and decision making and more effective use of resources.

Responsibilities and reporting

7. Orkney Islands Council is the administering authority for the Orkney Islands Council Pension Fund. The council delegates this responsibility to the Pension Fund Sub-Committee. The Sub-Committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Pension Fund Sub-Committee is required to review the effectiveness of internal control arrangements and approve the annual accounts.

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

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

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

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

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

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

Auditor Independence

13. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards

issued by the Financial Reporting Council and those of the professional accountancy bodies.

14. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2019/20 audit fee of £21,010 as set out in our Annual Audit Plan remains unchanged.

15. 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 in due course.

16. We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2019/20 annual accounts



Main judgements

Orkney Islands Council Pension Fund's financial statements give a true and fair view of the financial transactions of the Fund during the year ended 31 March 2020 and of the amount and disposition at that date of its assets and liabilities.

The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.

The annual accounts are the principal means of accounting for the stewardship of resources and performance

Our audit opinions on the annual report and accounts are unmodified

17. The annual accounts for the year ended 31 March 2020 were approved by the Orkney Islands Council Pension Fund Sub-Committee on 26 October 2020. We reported, within the independent auditor's report that:

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

18. We have nothing to report in respect of misstatements in the information accompanying the financial statements, the adequacy of accounting records or the information and explanations we received during the audit.

Objections

19. 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 to the Orkney Islands Council Pension Fund accounts.

The annual accounts were signed off in line with the timescales permitted to reflect Covid-19

20. The Scottish Government has advised that it considers the provisions made in Schedule 6 of the Coronavirus (Scotland) Act 2020 to be sufficient to allow each local authority to determine its own revised timetable for the Annual Accounts.

21. We received the unaudited annual report and accounts in accordance with our original audit timetable. The unaudited annual report and accounts provided for audit were complete and working papers were of a good standard.

22. There were challenges experienced by the accounting team due to working from home and the physical limitations on access to records and systems.

23. The impact of Covid-19 was also a factor for the audit team who had to adapt to new ways of working and conducting an audit remotely which resulted in some loss of productivity. In addition, we found that audit queries took longer to resolve than when we were on site. We will work with the Fund finance team to explore lessons learned with regards to remote working for the 2020/21 audit.

24. The annual report and accounts were signed off on 26 October 2020, in line with the revised timetable permitted to reflect the impact of Covid-19. The accounts were published prior to 31 October 2020, meeting the requirements of section 11 of The Local Authority Accounts (Scotland) Regulations 2014.

Applying the concept of materiality

25. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

26. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit. We assess the materiality of uncorrected misstatements both individually and collectively. On receipt of the unaudited annual report and accounts we reviewed our planning materiality calculations and concluded that they required to be slightly revised. The revised materiality figures are shown in [Exhibit 2](#).

Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£3.80 million
Performance materiality	£2.85 million
Reporting threshold	£100 thousand
Specific materiality - dealings with members	£0.93 million
Specific performance materiality - dealings with members	£0.70 million

Source: Audit Scotland

Risks identified at the planning stage and our audit work to address these

27. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance in relation to these risks

28. We identified two significant risks of material misstatement in relation to the financial statements in 2019/20 at the planning stage. At the conclusion of our audit we have no issues to report from our work on the risks of material misstatement and we have gained sufficient assurance to support our audit opinions.

Significant findings to report on the annual report and accounts

29. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our

view about the qualitative aspects of the body's accounting practices. We have no significant findings to report around the qualitative aspects covering accounting policies, accounting estimates and financial statements disclosures.

30. The significant findings are summarised in [Exhibit 3](#).

Exhibit 3

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Governance Statement</p> <p>The Delivering Good Governance in Local Government: Framework document, outlines the required content of the Annual Governance Statement. It is a requirement that the Fund outline any significant governance issues encountered in 2019/20 and present an agreed action plan showing the action taken or proposed. The Annual Governance Statement in the draft annual report and accounts did not include this information.</p> <p>In addition, the Annual Governance Statement did not include any reference to the Covid-19 global pandemic and the Fund's response to this.</p>	<p>The Annual Governance statement was updated to reflect the significant issues in 2019/20, which included narrative on the impact of the global coronavirus pandemic.</p> <p>We are satisfied the revised disclosures are in line with the requirements of the Framework document.</p>

Source: Audit Scotland

We did not identify any misstatements above our reporting threshold

31. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected. There were no misstatements above our reporting threshold identified from the 2019/20 audit.

Good progress was made on prior year recommendations

32. The Fund has made good progress in implementing our prior year audit recommendations. More information on these recommendations is included in [Appendix 1](#).

Part 2

Financial management

Main judgements



The annual performance of the Fund was significantly impacted by Covid-19. At 31 December 2019 the value of the Fund's assets was £432.6 million but by the end of March the value fell to £376.6 million as a result of Covid-19.

Despite the poor annual performance of the Fund, the liabilities remained fully funded with an estimated funding level of 104.6 per cent.

The Fund has appropriate and effective arrangements in place for financial management.

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





The annual performance of the Fund was significantly impacted by Covid-19

33. Pension fund finances are independently assessed every three years by an actuary. This assessment determines the employer contribution rates and deficit funding payments for the upcoming three-year period and takes account of the strength of employer covenants and the fund's investment strategy.

34. The Fund's performance in 2019/20 is summarised in [Exhibit 4](#).

Exhibit 4

Assets, funding level and investment performance

Decrease in net assets	Decrease in estimated liabilities	Funding level	Investment performance
 <p>(-£14.1 million) (-3.5 per cent)</p>	 <p>(-£38 million) (-9.7 per cent)</p>	 <p>112.7 per cent 2017 Funding valuation</p>	 <p>(-4.1 per cent) Return on investments 2019/20</p>
<p>£376.6 million Closing net assets as at 31 March 2020</p>	<p>£353 million Closing liabilities as at 31 March 2020</p>	<p>104.6 per cent 31 March 2020 Interim Funding valuation</p>	<p>6.5 per cent Return on investments over 5 years</p>

35. The information contained in [Exhibit 4](#) demonstrates that there has been a reduction in the performance at the Fund, both in terms of investment returns and in terms of funding level. This reflects the year end impact of Covid-19 on global markets. At 31 December 2019, and prior to the global coronavirus pandemic the Fund was reporting investment assets of £432.6 million, including an unrealised gain of £31.9 million. At the year end net assets had reduced to £376.6 million with the biggest contributing factor being an unrealised loss of £42.1 million.

Despite the poor annual performance of the Fund, liabilities remained fully funded with an estimated funding level of 104.6 per cent

36. The March 2017 triennial valuation for the Fund (issued in December 2017) reported that fund assets were sufficient to meet 112.7 per cent of its liabilities. The interim valuation by the Fund's actuary estimated that the funding level had decreased to 104.6 per cent as at 31 March 2020. This interim valuation uses the same base data as the triennial funding valuation, rolled forward to take account of changes in membership and updated assumptions.

37. Maintaining the funding position is becoming increasingly challenging due to a number of factors, including Covid-19, economic growth and the impact of EU withdrawal. Pension specific issues such as the scheme cost cap mechanism, guaranteed minimum pension (GMP) equalisation and the McCloud ruling on age discrimination within pension schemes are also likely to impact on the funding position in the coming years.

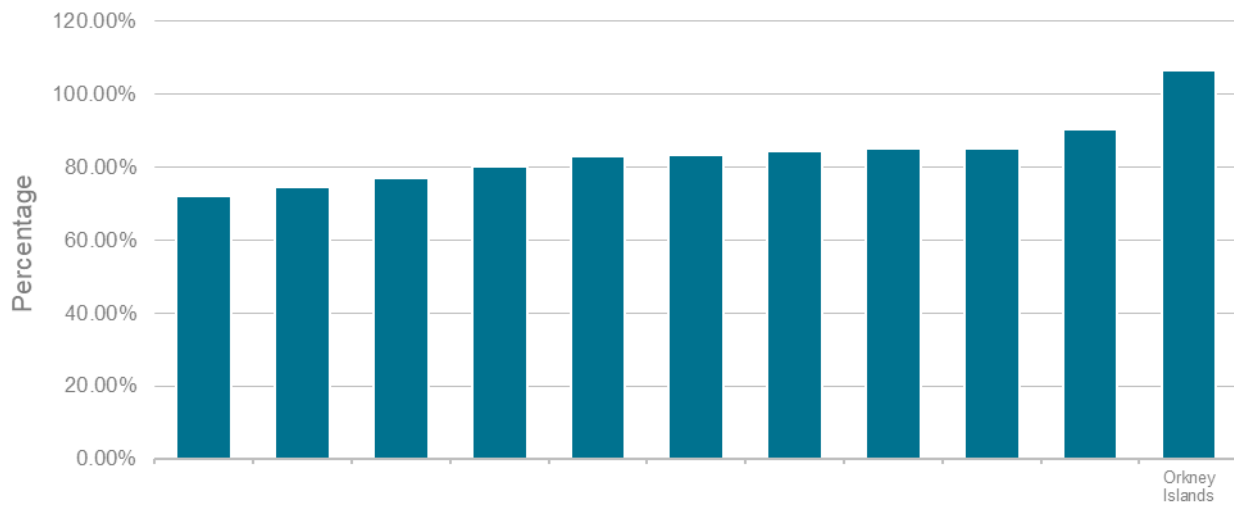
38. The Fund has considered these challenges and continues to monitor risks through the corporate risk register. The funding strategy statement and investment strategy are reviewed and revised following actuarial valuations to ensure that the Fund is well placed to continue to pay its liabilities.

39. Hymans Robertson provided an estimate of the promised retirement benefits at 31 March 2020 using a roll forward approximation from the latest formal funding valuation as at 31 March 2017. These have been estimated at £353 million (£391 million in 2018/19), showing a 9.7 per cent decrease. This estimate uses assumptions in line with Internal Accounting Standards (IAS) 19 requirements, for the purposes of the Fund's financial statements. It is not directly comparable to the liability measures on a funding basis.

40. The IAS 19 calculations give a guide to the relative positions of the Fund in terms of funding level. We have considered the performance across the Scottish Local Government Pension Schemes (LGPS) in [Exhibit 5](#) and note that Orkney Islands Council Pension Fund has the highest ratio of assets to liabilities.

Exhibit 5

LGPS pension funds – Net assets as a percentage of IAS 19 liability (unaudited figures)



Source: 2019/20 LGPS pension fund unaudited financial statements

41. The Fund is committed to ensuring it has appropriate resources in place to support ongoing pension administration activities, along with strategies and plans that take account of future challenges.

Financial management arrangements were appropriate and effective

42. The Head of Finance for Orkney Islands Council is the Proper Officer responsible for Orkney Islands Council Pension Fund. The financial regulations of Orkney Islands Council, as administering authority, apply to the Fund. We consider these to be comprehensive, and current, and promote good financial management.

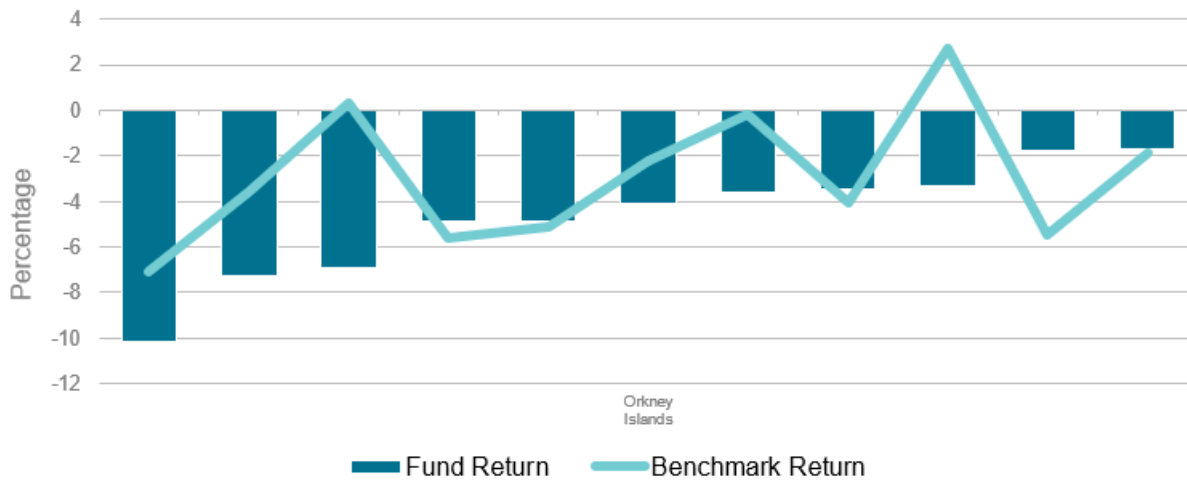
43. Investment and administration performance reports are submitted to the Pension Fund Sub-Committee on a quarterly basis. Reports are comprehensive, covering analysis of fund managers, review of asset allocation and a review of the markets. Also, through our attendance at the Pension Fund Sub-Committee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

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

Investment performance in 2019/20

45. Financial year 2019/20 has been a challenging year for investment performance for most LGPS pension funds across Scotland as illustrated in [Exhibit 6](#).

Exhibit 6 LGPS pension funds – Net return on investment 2019/20 (unaudited figures)



Source: 2019/20 LGPS pension fund unaudited financial statements

46. Investment performance across the Local Government Pension Scheme funds was broadly similar with all eleven funds reporting negative returns for the year to 31 March 2020. The Fund achieved a return of -4.1 per cent on its investments, which was 1.9 per cent behind the fund benchmark of -2.2 per cent for 2019/20.

47. [Exhibit 6](#) shows that several of the funds performed behind the agreed benchmark and only five Funds managed to outperform the agreed benchmark.

48. Orkney Islands Council Pension fund performed marginally better than the national average return of -4.7 per cent. The Fund revised their investment strategy in early 2019 to diversify the Fund's investments and reduce risk over the long term. The overall aim of the fund is to outperform the five year benchmark. [Exhibit 10](#) in the value for money section shows that the longer term performance is consistently above the benchmark.

Financial systems of internal control operated effectively

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

50. 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 2019/20.

51. Our review of the systems which are specific to the pension fund identified three areas where there was an opportunity to improve the control environment:

- access rights to the Altair system could be tailored to the needs of the individual user
- regular reconciliations between the payroll and pension system could be conducted with regards to benefits payable

- there is currently no procedure in place to check the ongoing validity of payments to overseas pensioners.

52. Full details of the key control weaknesses identified during our year end audit and our recommended actions are detailed in [Appendix 1](#).

53. Overall, we found that key controls are operating satisfactorily, and the issues identified were not so significant they could affect the Fund's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

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

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

55. We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering body's (Orkney Islands Council) arrangements for the prevention and detection of fraud and corruption. A revised whistleblowing policy was approved by the Human Resources Sub-Committee in November 2019, however, the Audit Scotland contact information was incorrect.



Recommendation 1

We recommend the whistleblowing policy is updated with the correct Audit Scotland contact information.

56. We have concluded that appropriate arrangements are in place within the board for the prevention and detection of fraud, error and irregularities, bribery and corruption. We are not aware of any further specific issues that we need to bring to your attention.

Part 3

Financial sustainability



Main judgement

The Fund continued to receive sufficient contributions in year to cover payments made to pensioners.

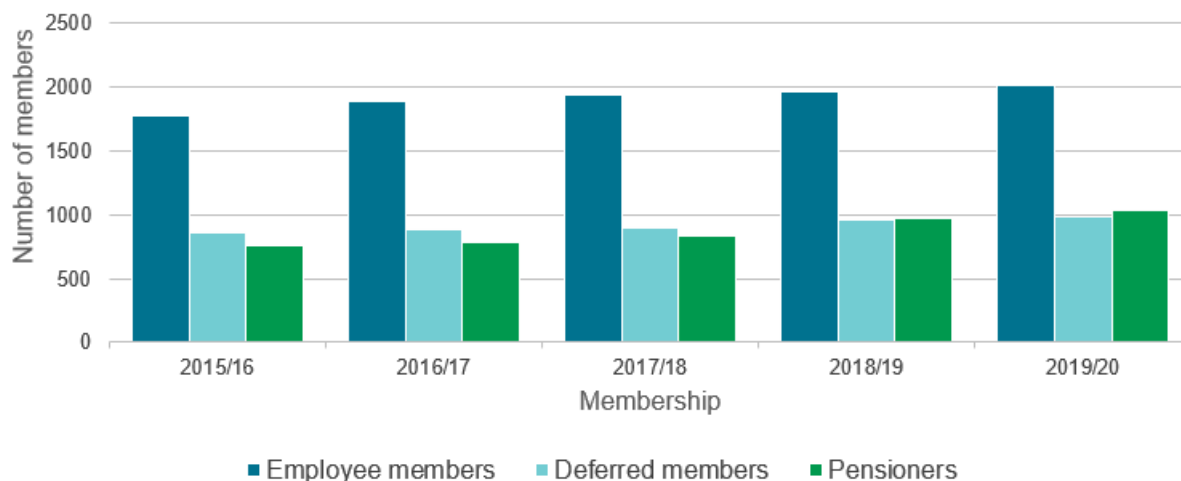
The Fund's three year funding and investment strategy will be reviewed following the next full triennial valuation, due to be completed by 31 March 2021. This will determine the level of employer contribution rates from 2021/22 onwards.

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

Membership levels continue to increase

57. The Fund is a multi-employer fund with members from five admitted bodies in addition to members employed by Orkney Islands Council. 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 2019/20 unaudited financial statements

58. Membership of the fund increased by 147 to 4,048 members at 31 March 2020; an increase in membership of 3.6 per cent. The impact of auto-enrolment continues to contribute to the increase in employee members.

59. The Fund gives its members a guarantee that in exchange for contributions during their employment, it will pay a pension until the end of each member's life. It

is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

60. In 2019/20 the number of pensioners receiving a pension increased by 67 taking the total to 1,041. The number of pensioner members continues to increase steadily each year, however, the number of active members continues to outweigh the number of pensioners. Cash flows received from dealings with members continue to be positive as the contributions received in year exceed the amount paid out in benefits.

61. Future membership numbers are difficult to predict with any certainty as they are dependent on a number of factors including employer budgets, recruitment decisions, and promotion of the pension scheme.

62. With most employers still open to new membership and with continuing support from auto enrolment, the recent trend of growth in membership seems likely to continue for the foreseeable future.

Contributions

63. Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards. The current funding surplus is being used to subsidise and stabilise contribution rates. The approximate split of all contributions received in year is set out at [Exhibit 8](#).

Exhibit 8 Contributions in 2019/20

	Administering authority £m	Admitted bodies £m	Total £m
Employer contributions	6.854	0.788	7.642
Employee contributions	2.384	0.291	2.675
Strain Contributions	0.015	0.000	0.015

Source: Orkney Islands Council Pension Fund 2019/20 unaudited financial statements

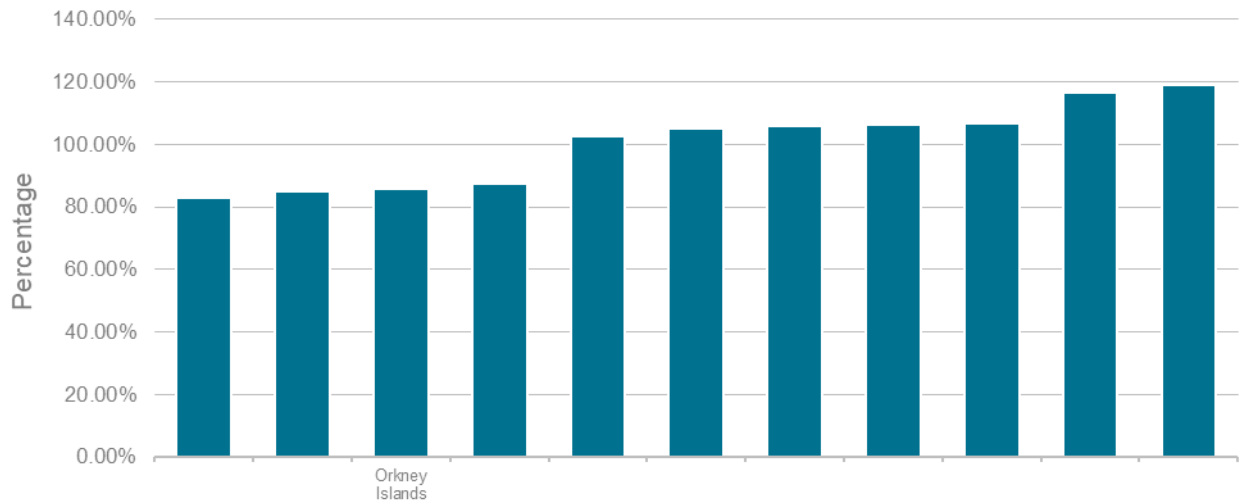
64. The Fund reported a surplus from dealings with members of £2.138 million in 2019/20. This means that member contributions exceeded pension payments.

65. Orkney Islands Council Pension Fund is one of only four Scottish Local Government Pension Schemes which receives more in contributions than they pay out in benefits as shown in [Exhibit 9](#). This demonstrates a relatively good position in terms of financial sustainability as the Fund is not reliant on investment income to support annual payments to pensioners.

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

Exhibit 9

LGPS pension funds – Benefits Payable as a proportion of contributions receivable (unaudited figures)



Source: 2019/20 LGPS pension fund unaudited financial statements

The Fund will require to view its funding strategy and investment strategy following the completion of the next triennial valuation

67. The funding strategy statement is a summary of the Fund's approach to funding liabilities and sets out the level of employer and employee contribution rates required to ensure sufficient resources are available to provide for members' pensions and lump sum benefits. Following each triennial valuation, the Fund reviews and revises the funding strategy statement. The next full review is due to be completed by 31 March 2021.

68. The investment strategy is set for the long-term but is monitored continually and reviewed every three years using asset-liability modelling to ensure that it remains appropriate to the profile of the Fund's liabilities.

69. Details of the current funding strategy statement and investment strategy are included within the Fund's 2019/20 annual report and accounts and both will be reviewed following the completion of the triennial valuation. The outcome of the review of the funding strategy will determine the level of employer contribution rates from 2021/22 onwards.

Part 4

Governance and transparency



Main judgements

The Fund has effective governance arrangements that support scrutiny by the Pension Fund Sub-Committee.

The Covid-19 pandemic had a limited impact on governance arrangements at the Fund. We consider the changes made to be proportionate and appropriate.

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.

The governance and transparency arrangements support good governance and accountability

70. Our previous year's conclusion is still relevant, that overall the fund has appropriate governance arrangements, as there has been no significant change during 2019/20, with the exception of specific comments below on the response to the Covid-19 outbreak in March 2020. The governance and transparency arrangements we consider include:

- Pension Fund Sub-Committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of the Pension Fund Sub-Committee
- the reporting of performance and whether this is fair, balanced and understandable.

The Covid-19 pandemic had a limited impact on governance arrangements from March 2020

71. The impact of Covid-19 from March 2020 on the governance arrangements was minimal with only one meeting of the Pension Fund Sub-Committee being cancelled. All other meetings continued in line with the planned programme albeit virtually.

72. Meetings were held remotely using Microsoft Teams software and from August 2020 members of the press were invited to attend for publicly available items. Although the minutes for all meetings are available from the Orkney Islands Council website, there is no link to audio castings of the Pension Fund Sub-Committee. Openness and transparency of the meetings could be improved by providing audio recordings via the Council website.



Recommendation 2

We recommend that the Fund considers using audio casting for meetings of the Pension Fund Sub-Committee to improve openness and transparency.

73. We consider the measures taken by the Fund to be proportionate and appropriate.

Appropriate arrangements are in place to comply with the Pensions Regulator Public Service Code

74. 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 2019/20 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.

75. As part of our audit work, we found that there were a small number of breaches of the regulations relating to overdue contributions. There is no register held by the Fund detailing the breaches in year and there is a risk that an issue is not raised with management which requires to be reported.



Recommendation 3

We recommend the Fund creates a register of all breaches to inform the decision over whether to report issues to the Pensions Regulator.

76. We have confirmed that the breaches of the Code did not require to be reported to the Pensions Regulator in 2019/20.

The SSAB consultation on the future structure of the Local Government Pension Scheme in Scotland found the majority of respondents were in favour of retaining the existing structure

77. In June 2018 the Scottish Scheme Advisory Board (SSAB) commenced a consultation on the future structure of the Local Government Pension Scheme in Scotland and identified four potential options:

- Option 1: retain the current structure of eleven funds
- Option 2: promote cooperation in investment and administration between the eleven funds
- Option 3: pool investments between the eleven funds, or
- Option 4: merge the eleven funds into one or more funds.

78. The SSAB commissioned the Pensions Institute to consult with a range of stakeholders, including employers and employee representative groups but not investment managers, between June and December 2019. The consultation asked stakeholders to consider the advantages and disadvantages of the current scheme

structure against the other three options presented. Orkney Islands Council Pension Fund's response to the consultation stated that the Fund's preference was to retain the current structure.

79. In November 2019 the outcome of the consultation was published. This showed that the majority of respondents (36 out of 53) were in favour of either option 1 or option 2, with 9 of the 11 administering authorities preferring to retain the existing structure and promote cooperation in investment and administration between the funds.

80. Following the publication of the report, the Scheme Advisory Board wrote to the Cabinet Secretary stating that it intended to commission further work on the merger model. The Cabinet Secretary has encouraged the continuing work to look at the structure of the Local Government Pension Scheme in Scotland and monitor the impact of pooling in England and Wales. The SSAB is in the process of undertaking scoping work to expedite this.

81. We will continue to monitor developments in this area and report on any potential implication for the future organisation or operation of the Fund.

Part 5

Value for money



Main judgements

The impact of Covid-19 on global markets reduced annual returns significantly but investment performance continues to outperform medium and longer term benchmarks.

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

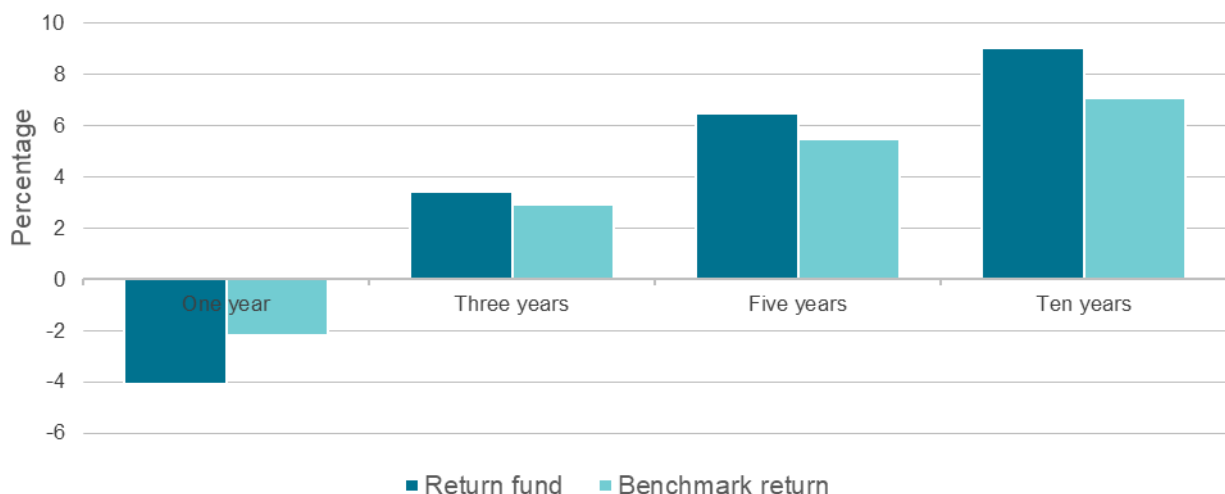
Value for money is concerned with using resources effectively and continually improving services.

Investment performance continues to outperform benchmarks over the medium and longer term

82. The Pension Fund Sub-Committee meets regularly throughout the year. Investment reports outlining investment performance are presented to the committee on a quarterly basis.

83. [Exhibit 10](#) shows that over the year, the Fund performed below the benchmark generating a return of -4.1 per cent against a benchmark of -2.2 per cent. The medium-term performance is stronger with the Fund performing above benchmark, 6.5 per cent against the benchmark of 5.5 per cent over the last five years. Long term performance shows even more healthy returns of 9.0 per cent against the benchmark of 7.1 per cent over the last ten years.

Exhibit 10 Fund investment performance



Source: Orkney Islands Council Pension Fund 2019/20 unaudited financial statements

At 31 March 2020 the majority of the value of the Fund's assets was held in equities and pooled investments

84. The investment strategy of the Fund is included in the Statement of Investment Principles and was last updated in February 2019.

85. The revised investment strategy focuses on increasing the diversification of the portfolio, including increasing allocations in income generating assets. The strategy also takes the unpredictability of future economic conditions into consideration and continues to diversify in order to be more resilient to future challenges.

86. The revised asset allocations and range guidelines were applied with effect from December 2019. The Fund started the transition process with the appointment of a new fund manager, Barings. The transition was delayed as a result of uncertainty within the financial markets due to Covid-19 and at the year end 85 per cent of the Fund assets remained in growth seeking assets such as equities and pooled investments.

87. Investment return and risk are inextricably linked, and it is not possible for us to comment on the relative performance of the Fund's investments given the risk exposure of the asset allocation and investments made. Although asset allocation is moving in line with the Fund's revised investment strategy, the Fund retains overweight positions in equity.

Performance of investment managers is subject to scrutiny

88. The Fund used two fund managers during the course of 2019/20, Baillie Gifford and Barings. Barings was appointed in quarter four of the 2019/20 financial year as part of the revised investment strategy.

89. Investment manager performance is reported on a quarterly basis to the Pension Fund Sub-Committee and the Fund's external investment advisor attends the meetings in an advisory capacity when required.

90. The performance summaries presented to each meeting of the Sub-Committee include details of performance of individual mandates against benchmark for each quarter of the current year, and over the last three and five years. This allows members of the Sub-Committee to scrutinise investment performance and to question officers on the reasons for any under-performance.

91. In addition, the Finance team carry out reviews including consideration of internal controls for each of the fund managers. Barings provided a valuation of the investment pool in which the Fund has an investment at 31 March 2020, however, while the Fund verified the number of shares held agreed to internal records, no work has been conducted by the Fund to validate the value of the investment. We are satisfied that the figures in the accounts are not materially misstated from our work on the competence, capability and objectivity of Barings and a review of the asset valuation process.



Recommendation 4

We recommend the Fund conducts work to assure themselves that asset valuations provided by the fund manager are reasonable and in line with expectation.

The Fund adequately scrutinises investment management expenses

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

93. External investment manager fees are agreed in the respective mandates governing their appointments. The fees are relative to the risk and complexity involved in managing a particular asset and strategy.

94. Investment management expenses have increased from £1.327 million in 2018/19 to £1.663 million in 2019/20. This was attributable to the additional management fees incurred when transferring the investment mandate from Baillie Gifford to Barings in January 2020.

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

Administrative expenses

96. Administrative expenses have increased by £0.023 million in 2019/20 to £0.309 million. 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, freedom of choice, and work arising from the Guaranteed Minimum Payment Reconciliation.

97. As a result of our audit recommendation in 2018/19, the Fund reviewed their administration performance targets. The Fund benchmarked their performance standards against other Scottish Local Government Pension Schemes and concluded no change was necessary as their targets were appropriate to the size of their operations.

Exhibit 11 Administration Performance

	Performance Standard (days)	Percentage processed within standard 2018/19	Percentage processed within standard 2019/20	Relative performance compared to prior year
Pension estimates	10	65.0 per cent	99.0 per cent	↑
Retirements	5	100.0 per cent	100.0 per cent	→
Transfers in	10	95.6 per cent	97.7 per cent	↑
Transfers out	10	94.7 per cent	100.0 per cent	↑
Refunds	5	93.6 per cent	100.0 per cent	↑

Source: Orkney Islands Council Pension Fund 2019/20 unaudited financial statements

98. There was a significant improvement in performance in 2019/20, primarily due to staff returning from extended leave so the pensions team was operating at full capacity.

National performance audit reports

99. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2019/20, we published reports which may be of interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

100. The Pensions Committee considered the LGPS supplement to the Local Government in Scotland: Financial Overview 2017/18 at its November 2019 meeting.

Appendix 1

Action plan 2019/20

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Whistleblowing policy</p> <p>A revised whistle blowing policy was approved by the Human Resources Sub-Committee, however, the contact information for Audit Scotland was out of date.</p> <p>Risk</p> <p>Whistle blowers would be unable to contact Audit Scotland using the information within the whistleblowing policy.</p>	<p>We recommend the whistleblowing policy is updated with the correct Audit Scotland contact information.</p> <p>Paragraph 56</p>	<p>Contact details will be updated.</p> <p>Head of HR</p> <p>31 December 2020</p>
2	<p>Audio casting of the Pension Fund Sub-Committee</p> <p>Minutes of all Pension Fund Sub-Committees are published on the Orkney Islands Council website. There is scope to improve transparency by including access to audio casting.</p> <p>Risk</p> <p>There is a risk that the business of the Pension Fund Sub-Committee is not seen to be transparent.</p>	<p>We recommend that the Fund considers using audio casting for meetings of the Pension Fund Sub-Committee to improve openness and transparency.</p> <p>Paragraph 73</p>	<p>There are resource implications to increasing audio casting to Sub-committee meetings and it is not presently planned to extend audio casting to sub-committees.</p> <p>Head of Executive Support</p>
3	<p>Breaches register</p> <p>There is no register held by the Fund detailing the breaches of the Pensions Regulator Public Service Code in year.</p> <p>Risk</p> <p>There is a risk that an issue is not raised with management which requires to be reported</p>	<p>We recommend the Fund creates a register of all breaches to inform the decision over whether to report issues to the Pensions Regulator.</p> <p>Paragraph 76</p>	<p>Agreed</p> <p>Pensions Manager</p> <p>31 December 2020.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
4	<p>Validation of fund manager valuations</p> <p>Barings provided a valuation of investments held at 31 March 2020. From our review of the document it was not possible to identify the Fund's share of assets. No work has been conducted by the Fund to validate the valuation provided by Barings.</p> <p>Risk</p> <p>There is a risk that a misstatement in the valuation is not noticed by the Fund on a timely basis.</p>	<p>We recommend the Fund conducts work to assure themselves that asset valuations provided by the fund manager are reasonable and in line with expectation.</p>	<p>The validation work was not completed as this was a new mandate and COVID-19 disruptions meant it was not picked up.</p> <p>Senior Manager (Corporate Finance)</p> <p>31 March 2021</p>
5	<p>Altair access rights</p> <p>The access rights to the Altair system are generic and are the same for all those within the pensions team. We did not identify any issues in relation to access rights as part of our audit testing.</p> <p>Risk</p> <p>There is a risk of fraud or error arising from inappropriate user permissions</p>	<p>We recommend that Altair system rights are tailored to the needs of the individual user.</p>	<p>A review of access rights will be undertaken.</p> <p>Pensions Manager</p> <p>31 March 2021</p>
6	<p>Pension and payroll reconciliations</p> <p>Our testing found that there is no reconciliation between the pensions system and the payroll system on a regular basis. Our testing did not find a significant variance at the year end between the systems.</p> <p>Risk</p> <p>There is a risk that payments made to pensioners via payroll are not in line with the calculated amounts on the pension system</p>	<p>We would recommend that reconciliations between the payroll system and the pensions system are carried out on a monthly basis.</p>	<p>Quarterly Reconciliations will be added to Payroll and Pension procedures.</p> <p>Pensions Manager</p> <p>31 December 2020.</p>
7	<p>Payments to overseas pensioners</p>	<p>We recommend procedures are in place to mitigate overpayments</p>	<p>Procedures to confirm 'proof of life' for</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>The fund currently has procedures for identifying deceased pensioners living in the UK but there are no such procedures for pensioners who live abroad. There are currently only 7 members who do not live in the UK.</p> <p>Risk</p> <p>There is a risk that overpayments are made due to the failure to identify a deceased member.</p>	<p>relating to pensioners living abroad.</p>	<p>pensioners living abroad will be investigated</p> <p>Pensions Manager</p> <p>31 March 2021.</p>
Follow up of prior year recommendations			
8	<p>Performance Measures</p> <p>The performance measures used to monitor the performance of the administration of the fund were set many years ago. There have been many developments in pension funds including freedom of choice.</p> <p>Risk</p> <p>The measures and targets may no longer be the most appropriate for the fund.</p>	<p>A review of the performance measures should be carried out to meet the needs of monitoring the funds administrative performance.</p>	<p>Complete</p> <p>Performance measures were reviewed in 2019/20 and a conclusion was presented to the Pension Fund Sub-Committee in February 2020.</p>
9	<p>Review of Local Government Overview Report –Pension Fund Supplement. Each year Audit Scotland produces an overview report supplement relating to Pension Funds, this is not currently reviewed by the Pension Fund Sub-Committee.</p>	<p>The Pension Fund Sub-Committee should review the Pension Fund Supplement of the Local Government Overview.</p>	<p>Complete</p> <p>The Local Government Overview Report was presented to the Pension Fund Sub-Committee in November 2019.</p>

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](#).

Add any risks arising from Covid-19 reported to those charged with Governance

Add any Add Audit risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1</p> <p>Risk of management override of controls</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 to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries. • Review of accounting estimates. • Focused testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business. 	<p>We have not identified any instances of management override from our testing.</p>
<p>2</p> <p>Estimation, judgements and Classification</p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments and the actuarial valuation. Investments include investments such as pooled funds, where valuations involve the application of judgement in determining appropriate amounts.</p> <p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity entails a risk of misstatement in the financial statements.</p>	<ul style="list-style-type: none"> • Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments. • Confirmation of valuations to valuation reports and/ or other supporting documentation. • Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary. • Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2019/20. 	<p>We gained appropriate assurance over the competence, capability and objectivity of the fund managers, the custodian and the actuary.</p> <p>The valuations were agreed to valuation reports provided by the custodian and the fund managers. A sample of investments were agreed back to third party information.</p> <p>The assumptions used by the actuary were compared to benchmark information and we concluded that these were reasonable.</p> <p>There were no issues arising from our work on estimates and we have concluded there is sufficient assurance to support our audit opinions.</p>

Add any Add Audit risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
<p>3</p>	<p>The whistleblowing policy was revised in 2019/20, however the contact details for Audit Scotland remain incorrect, with an old address and telephone number listed. There is a risk that other elements of the revised policy is out of date.</p> <p>Whistleblowers would be unable to contact Audit Scotland using the information within the whistleblowing policy.</p>	<p>Review revised policy.</p> <p>We reviewed the Whistleblowing Policy at the year end and no further changes have been made</p> <p>We have included a recommendation to management in Appendix 1</p>

Appendix 3

Summary of national performance reports 2019/2020

		 2019/20 Reports	
		Apr	
Social security: Implementing the devolved powers		May	
Scotland's colleges 2019		Jun	 Enabling digital government
		Jul	
NHS workforce planning - part 2		Aug	
Finances of Scottish universities		Sept	
NHS in Scotland 2019		Oct	
		Nov	
Local government in Scotland: Financial overview 2018/19		Dec	
Scotland's City Region and Growth Deals		Jan	 Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
		Feb	
		Mar	 Early learning and childcare: follow-up

Reports of relevant interest:

[Local Government in Scotland: Financial Overview 2018/19](#) –December 2019.

Orkney Islands Council Pension Fund

2019/20 Annual Audit Report

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