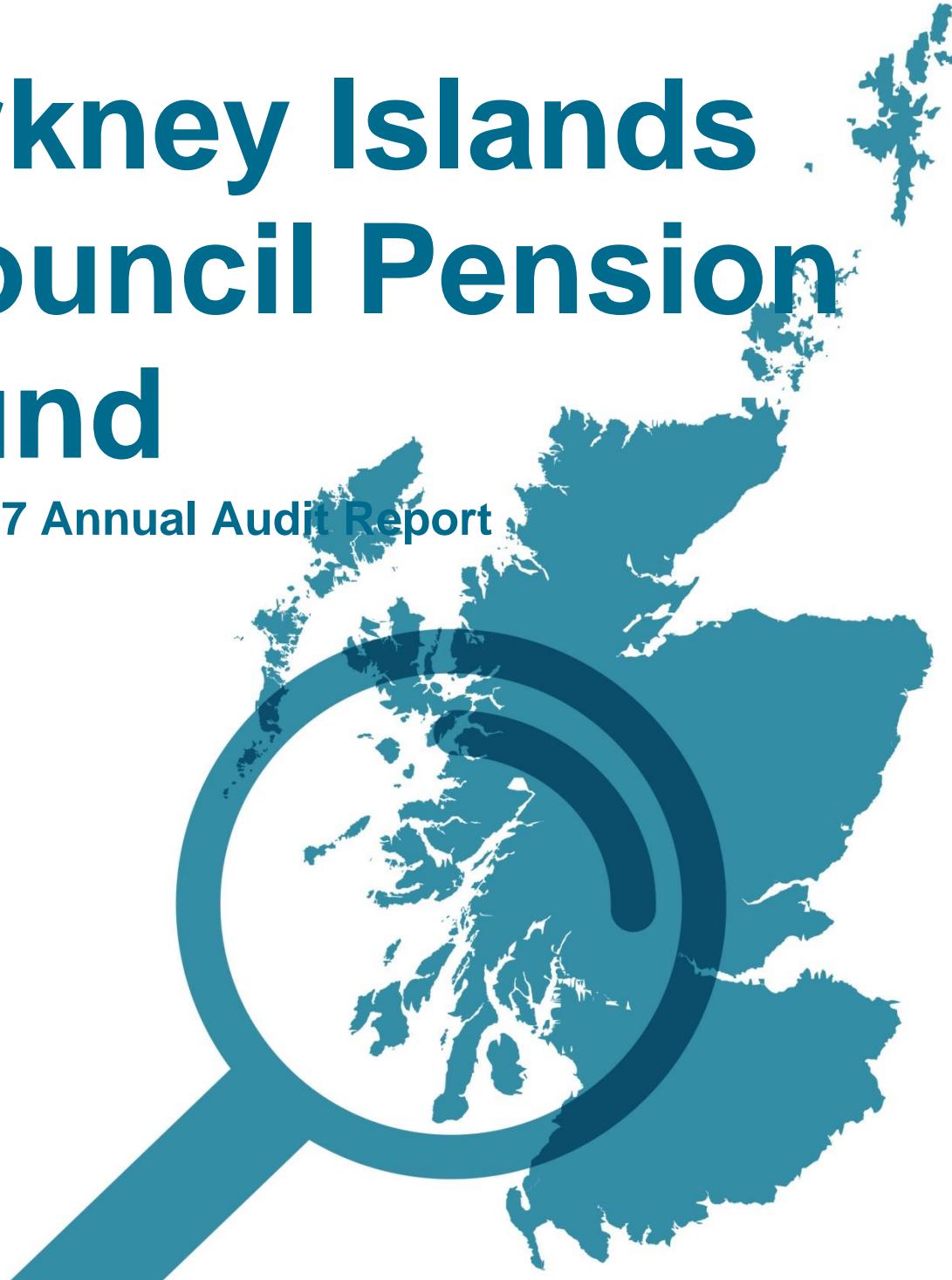


# Orkney Islands Council Pension Fund

2016/17 Annual Audit Report



 AUDIT SCOTLAND

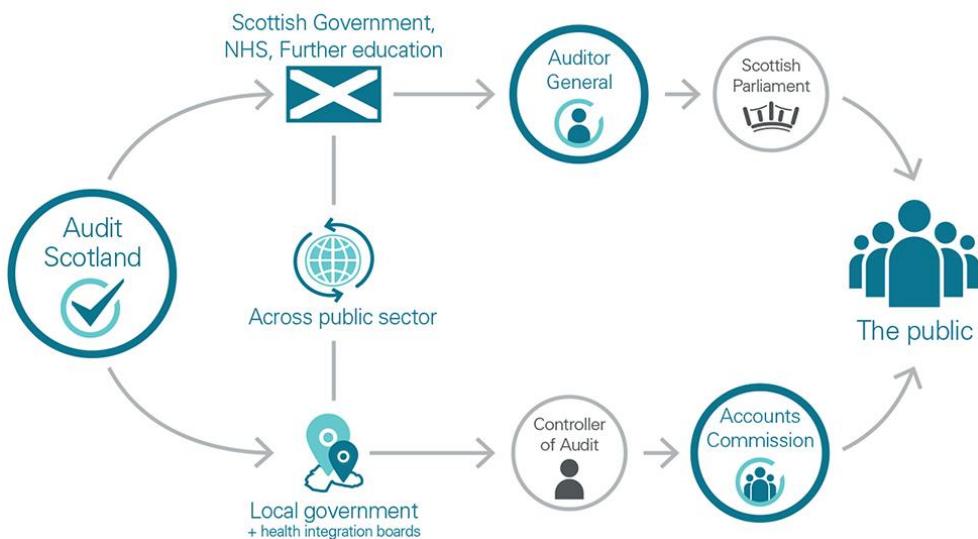
To Members of the Orkney Islands Council Pension Fund Sub-Committee and Controller of Audit

20 September 2017

# 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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## 2016/17 annual report and accounts

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

## Financial management and sustainability

- 2 The Orkney Islands Council Pension Fund (the Fund) has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.
- 3 Investments continue to perform above the local authority benchmark.
- 4 The interim valuation of the Fund in March 2017 reported that the funding level was 104.4% (114.4% at March 2014). This was primarily due to the continuing trend of falling real bond yields which have pushed up liability values.

## Governance and transparency

- 5 The Fund has effective governance arrangements in place that support scrutiny of decisions made by the pension fund sub-committee.
- 6 Decisions are open and transparent with minutes of meetings of the pension fund sub-committee available on the Orkney Islands Council website.
- 7 No material weaknesses in the accounting and internal control systems were identified.
- 8 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.

## Value for money

- 9 The Fund's performance is subject to regular review and scrutiny by the pension fund sub-committee. The Fund reviews the value for money that it receives from its investments on an ongoing basis and adequate arrangements are in place through monitoring of investment performance including participation in fee and performance benchmarking surveys.
- 10 Investment manager performance is reported on a quarterly basis to the pension fund sub-committee and Pensions Board. This is consistent with good practice.

# Introduction

**1.** This report is a summary of our findings arising from the 2016/17 audit of the Fund.

**2.** The scope of our audit was set out in our Annual Audit Plan presented to the February 2017 meeting of the Monitoring and Audit Committee. This report comprises:

- an audit of the annual accounts
- consideration of the wider dimensions 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 2016/17 have been:

- an interim audit of the fund's main financial systems and governance arrangements
- an audit of the fund's 2016/17 annual accounts including the issue of an independent auditor's report setting out our opinions.

**4.** Orkney Islands Council is the administering authority for the Fund. The council delegates this responsibility to the pension fund sub-committee who 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.

**5.** Our responsibilities as independent auditor 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.

**6.** As public sector auditors we provide independent opinions on the annual accounts. We also review and report on the arrangements within the Fund to manage its performance and use of resources such as money and assets. In doing this, we aim to support improvement and accountability.

**7.** Further details of the respective responsibilities of management and the auditor can be found in the Code of Audit Practice (2016),

**8.** This report raises matters from the audit of the annual accounts, risks or control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

**9.** Our annual audit report contains an action plan at Appendix 1 (page 24). It sets out specific recommendations, responsible officers and dates for implementation.

**10.** As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity the fee remains unchanged.

**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 2016/17 annual accounts



### Main judgements

**Unqualified audit opinion on the Fund's 2016/17 annual report and accounts.**

**No adjustments were required to the Fund's financial statements.**

### Unqualified audit opinions

**13.** The annual report and accounts for the year ended 31 March 2017 were approved by the Orkney Islands Council pension fund sub-committee on 20 September 2017. 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.** Additionally, we have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

### Submission of annual accounts for audit

**15.** We received the unaudited annual accounts on 28 June 2017, in line with our agreed audit timetable set out in our 2016/17 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 during the audit. This assisted the delivery of the audit to deadline.

### Risks of material misstatement

**17.** Appendix 2 (page 26) 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. Also included within the appendix are wider dimension risks, how we addressed these and conclusions.

The annual report and accounts are the principal means of accounting for the stewardship of resources and the performance in the use of those resources.

## Materiality

**18.** Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved (i.e. true and fair view). 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 undertaken during the planning phase of the audit and included in our Annual Audit Plan. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

**20.** On receipt of the annual accounts we reviewed our original materiality calculations and revised them based on the updated information available. Our materiality values are summarised in Exhibit 2.

## Exhibit 2

### Materiality values

Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 0.5% of net assets for the year ended 31 March 2017 based on the latest set of audited accounts.	£1.68 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 50% of overall materiality.	£0.840 million
<b>Reporting threshold (i.e., clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality. (With a maximum level of £100,000).	£0.017 million

## How we evaluate misstatements

**21.** There were no material adjustments to the unaudited financial statements arising from our audit which impact upon either the net returns on investments for the year or the net assets position at 31 March 2017.

## Significant findings

**22.** International Standard on Auditing 260 requires us to communicate to you significant findings from the audit. 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 Appendix 1 has been included.

## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Migration of Altair Pensions System</b></p> <p>The Fund has commenced a project to migrate manual pension records to Heywood's Pensions Administration system, Altair since 2012/13.</p> <p>The pace of migration to the Altair system is slow, with only around 75% of membership now transferred.</p> <p>The Fund requires to increase the pace of migration as this represents a reduction in the efficiency of service to the fund's members.</p>	<p>Resolution: The Fund has agreed to increase the pace of migration as a priority to ensure that the Altair system is fully operational in 2017/18.</p> <p><a href="#"><u>Appendix 1 – Point 1</u></a></p>
<p><b>2. Internal Control Coverage</b></p> <p>There has been no Internal Audit coverage of the Fund over the last few years due to the continued delay of full implementation of the Altair system. The Fund previously placed reliance on our interim audit work for the purpose of obtaining assurances for the internal systems of control.</p>	<p>Resolution: It was agreed with the Head of Internal Audit that an additional review of pension administration would be carried out and reported prior to sign off of the financial statements to gain assurance for the governance statement.</p> <p>The review of pension administration identified no significant issues and therefore the Fund is able to obtain assurance over the internal controls operating in the pensions section for 2016/17.</p>
<p><b>3. Local Code of Good Governance Arrangements</b></p> <p>A new Local Code of Corporate Governance was updated by SOLACE in 2016. However, the Fund has not carried out a review against the Code as part of their consideration as part of their preparation of the annual governance statement.</p>	<p>Resolution: The Council's Head of Finance and Pensions Manager plan to undertake a review of the Code for 2017/18</p> <p><a href="#"><u>Appendix 1 - point 2</u></a></p>

## Other findings

**23.** Our audit identified a number of presentational, consistency and disclosure issues as well as errors in a number of prior year figures. The presentational issues and errors were discussed with management and were subsequently adjusted and reflected in the audited annual report and accounts.

### Governance Statement

**24.** Significant changes were required to the Governance Statement which was submitted for audit. We liaised with officers to ensure the revised Governance Statement complied with new guidance which was issued for 2016/17 and included appropriate disclosures and assurances.

# Part 2

## Financial management



### Main judgements

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

**Investment performance of the Fund increased by 24.4% performing above the Fund's benchmark of 21.4%**

**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.**

### Financial performance in 2016/17

**25.** 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. The Fund's performance in 2016/17 is summarised in Exhibit 4

### Exhibit 4

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

Increase in Net assets	Increase in estimated actuarial liabilities	Funding level	Investment performance
 £69.4 million (+26%)	 £ 61.6 million (+23.6%)	 114.4% 2014 Funding valuation	 24.4% Return on investments 2016/17
<b>£335.3 million</b> Closing Net assets	<b>£ 322.8 million</b> Closing liabilities	<b>104%</b> 31 March 2017 Interim valuation	<b>12.5%</b> Return on investments over 5 years

Source: 2016/17 Orkney Islands Council Pension Fund

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**26.** The Council approved the Fund's revised investment strategy in October 2016. The Fund's investments were restructured in February 2017 resulting in a new allocation being made to the Baillie Gifford's Multi Asset Growth Fund.

**27.** The bulk of the Fund is held in growth-seeking assets rather than those considered to be more defensive. Direct holdings in equities accounted for 58.7%, with indirect holdings in Diversified Growth and Multi-Asset Growth pooled funds accounting for a further 26.7% of the Fund's portfolio as at 31 March 2017.

**28.** The net assets of the Fund increased to £335.3 million at 31 March 2017 from £265.9 million at 31 March 2016. This increase of £69.4 million (26%) reflected the favourable market conditions faced by investors over the year.

**29.** During 2016/17 contributions to the Fund amounted to some £10.9 million. This was in excess of the benefits paid out which totalled £6.8 million.

**30.** At the same time, the Fund's Actuary, Hymans Robertson, estimated that pension liabilities had risen from £261.2 million at 31 March 2016 to £322.8 million at 31 March 2017 (£61.6 million increase). The liabilities have been estimated by rolling forward cash flows and investment returns from the 2014 triennial valuation. The increase in fund liabilities reflects the sharp decline in the yield on government bonds.

**31.** Based upon the interim valuation by the actuary, the Fund's funding level is estimated to be 104% as at 31 March 2017. However it should be recognised that not all funds have liabilities assessed on the same prudential scales. The use of differing actuarial firms and assumptions creates difficulties in direct comparisons.

## Financial management arrangements

**32.** The Head of Finance for Orkney Islands Council is the proper officer responsible for the Fund and is part of the corporate management team and reports directly to the Chief Executive.

**33.** 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.

**34.** 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. To enhance scrutiny, the Fund plan to report to the pension fund sub-committee on their reviews of fund manager and custodian internal control reports.

**35.** We have concluded that the Funds' overall financial management arrangements are satisfactory.

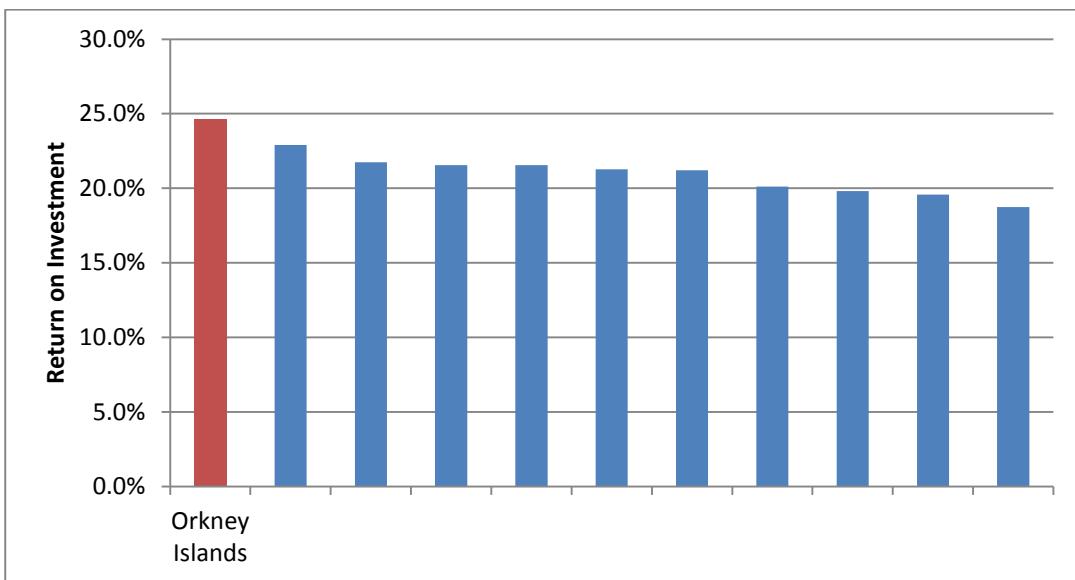
## Financial outcomes

**36.** 2016/17 has been a relatively good year for investment performance for most LGPS pension funds across Scotland as illustrated in Exhibit 5. However, the financial outcome for investment management should be considered over a much longer period than just one year, and is a product of asset allocation, risk appetite and manager performance, as well as whether markets went up or down.

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

## Exhibit 5

LGPS pension funds – Net return on investment 2016/17 (unaudited figures)



Source: 2016/17 LGPS pension fund unaudited financial statements

**37.** With effect from 1 April 2016, the performance monitoring of the Pension Fund has been measured against the PIRC Local Authority Pension Fund Universe. Baillie Gifford's revised performance target for this accounting period is to outperform the PIRC Local Authority Pension Fund Universe benchmark by 1% p.a. when assessed over rolling 5 year periods.

**38.** The Fund achieved a return of 24.4% during 2016/17 (benchmark 21.4%) and the average performance over the last 5 years of 12.5% remains well ahead of the benchmark of 10.7%.

**39.** We have concluded that the Fund's overall performance is good. However, the Fund requires to continually monitor performance as it is unlikely that high performance returns will continue.

## Internal controls

**40.** The Accounts Regulations 2014 require the pension fund sub-committee to consider the findings of an annual review of the system of internal control and to approve the Annual Governance Statement for the Fund.

**41.** The 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 2016/17.

**42.** As part of our work we also took assurance from the work of Internal Audit regarding the key controls within the Fund's pension systems. No material weaknesses in the accounting and internal control systems were identified which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

**43.** Each year, the 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 the Fund has a system that documents management review and observations from these reports.

**44.** The pace of migration to the Altair system is slow, with only around 75% of membership now transferred. Priority is given to members with status changes where calculations are made. The Fund plans to upload the remaining members during 2017/18. The Fund requires to increase the pace of migration as this represents a reduction in the efficiency of service to the fund's members. There is also 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.

#### **Appendix 1 - points 1 and 3**

**45.** The Fund confirmed that annual benefits statements for all active and deferred members were issued for 2016/17 by the August 2017 deadline.

#### **Standards of conduct and arrangements for the detection and prevention of fraud and corruption**

**46.** The Fund complies with the relevant fraud and irregularity policies of Orkney Islands Council, including the Code of Conduct for members and officers, whistleblowing policy and an anti-fraud strategy. These were reviewed as part of our audit of the Council. No issues were identified for inclusion in this report.

**47.** We concluded that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2016/17.

#### **National Fraud Initiative**

**48.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

**49.** NFI activity is summarised in Exhibit 6. The council investigated matches using procedures overseen by the Finance Manager. Reports that compare pensions to payroll and pensions to registered deaths are relevant to the pension scheme, and provided a number of leads for investigation.

**Exhibit 6**

Total number of matches	Number recommended for investigation	Completed/closed investigations
		

**55**                   **18**                   **18**

Source: Orkney Islands Council (figures as at 31 August 2017)

- 50.** The number of discrepancies found this year was reported as low and were mostly due to minor delays in the reporting of deaths. The matching exercise identified no frauds or overpayments, however, remains an important control which provides a formal assurance that the council's records are consistent with those of other public bodies.

# Part 3

## Financial sustainability



### Main judgement

**The March 2014 triennial valuation reports that the fund assets were sufficient to meet 114.4% of its liabilities. The interim valuation, by the Fund's actuary, estimated that the funding surplus had decreased to 104.4% primarily due to the continuing trend of falling real bond yields which have pushed up liability values.**

### Funding position

**51.** There is a timing difference of many years between the receipt of contributions and the payment of pensions. Financial sustainability means that the fund maintains the capacity to meet the current and future needs of its members, despite changes of investment performance and life expectancy.

**52.** In assessing financial sustainability we are concerned with whether:

- the Fund's liabilities are greater or smaller than the Fund's assets (the actuarial position)
- contribution rates strike an appropriate balance between the needs of the schemes and the needs of employers
- where there is a deficit, long term recovery measures are in place
- the Fund's investments have a profile of risk that is consistent with expected cash flows.

**53.** Effective investment strategy, investment management and regular actuarial review are crucial to sustainability.

**54.** The March 2014 triennial valuation reports that the fund assets were sufficient to meet 114.4% of its liabilities. The interim valuation, by the Fund's actuary, estimated that the funding surplus had decreased to 104.4% primarily due to the continuing trend of falling real bond yields which have pushed up liability values.

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.

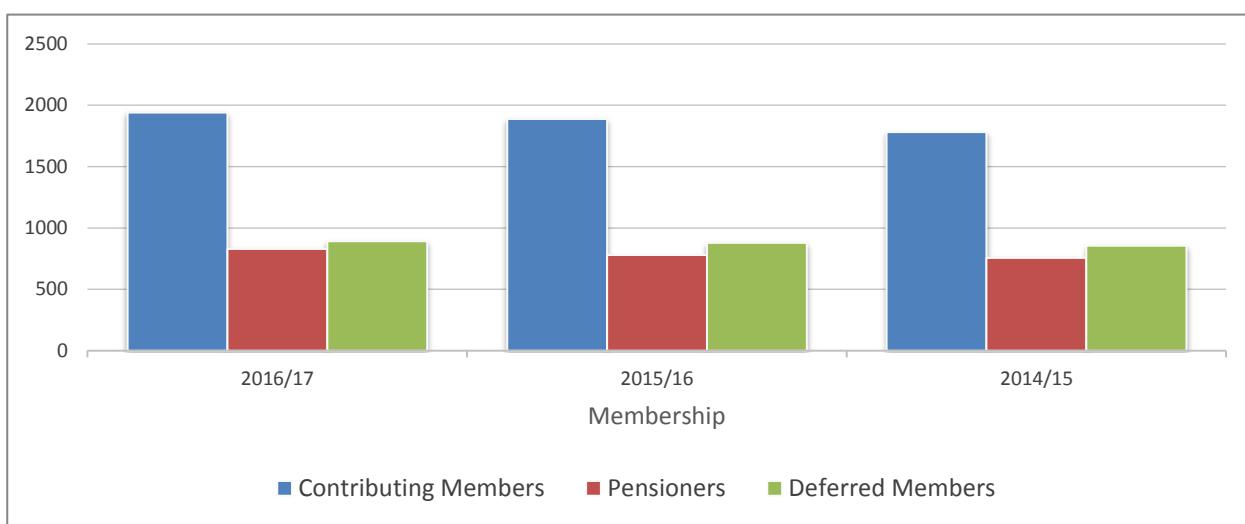
### Membership levels

**55.** The Fund is a multi-employer fund with members from eight admission bodies in addition to members employed by Orkney Islands Council. Orkney Ferries Limited and Pickaquoy Centre Trust members made up 85 per cent of active admitted bodies' members. Given the size and nature of these employers the funding risk associated with default is seen as relatively low.

**56.** The current membership profile is shown at Exhibit 7.

## Exhibit 7

### Fund membership



Source: Orkney Islands Council Fund 2016/17 unaudited financial statements

**57.** Membership of the fund increased by 116 to 3,663 members at 31 March 2017; an increase in active members of 3.2%.

**58.** The Fund gives its members a guarantee that in exchange for contributions during their employment, the Fund 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 needs of its members.

## Contributions

**59.** Following the last triennial valuation in 2014, the Actuary agreed employer contribution rates with individual employers for the period 2015 to 2018. An element of these employer costs includes deficit recovery contributions to support employers' financial planning. The approximate split of all contributions received in year is set out at Exhibit 8.

## Exhibit 8

### Contributions in 2016/17

	Administering authority £000	Admitted bodies £000	Total £m
Employer contributions	6,716	832	7,548
Employee contributions	2,030	268	2,298
Strain Contributions	26	0	26

Source: Orkney Islands Council Pension Fund 2016/17 unaudited financial statements

**60.** The Fund reported a surplus from dealings with members of £4.1m in 2016/17. This money, together with accumulated income from investments, helps to offset the volatility of investment returns.

**61.** Overall, the actuary believes the fund has a sound financial position that will allow it to meet both the current and future needs of its members. However, it is clear that the outlook for public spending remains very challenging and the need for spending constraints and budget reductions will continue. Any staff reduction schemes introduced by employers will place pressure on the Fund, arising from lower member contribution levels and increased administration workloads.

# Part 4

## Governance and transparency

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### Main judgements

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

**Decisions are open and transparent with minutes of meetings of the pension fund sub-committee available on the Orkney Islands Council website**

### Governance arrangements

**62.** Orkney Islands Council is the administering body for the Fund. The council has delegated responsibility for governance to the pension fund sub-committee.

**63.** Members of the pension fund sub-committee, supported by the pensions board, are responsible for establishing arrangements to ensure the proper conduct of the affairs of the Fund in accordance with the law and proper standards and for monitoring the adequacy and effectiveness of these arrangements.

**64.** As part of our work we reviewed various aspects of governance that apply to the Fund including standing orders, financial regulations, Codes of Conduct for officers and members, anti-fraud and corruption arrangements, and arrangements for reporting to the pension regulator on breaches of regulation. However, we noted that the Fund's risk register was last reviewed by the pension fund sub-committee in March 2016.

### Appendix 1 – point 4

**65.** Members of the Fund should be able to hold the Fund to account for the services it provides. Transparency means that fund members should have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using its resources.

**66.** Overall, we concluded that the Fund has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

### Governance structure

**67.** The corporate governance framework for the Funds is centred on the pension fund sub-committee which is supported by a pensions board. Orkney Islands Council's Head of Finance has delegated authority for the implementation of the Fund's investment strategy.

**68.** Based on our observations and audit work our overall conclusion is that the governance arrangements within the Fund are operating effectively and are open and transparent.

## Governance processes and committees

**69.** The Council has delegated the administration, management and investment of the Fund to the pension fund sub-committee which comprises 7 councillors from the council.

**70.** The Public Service Pension Act 2013 introduced new governance arrangements for LGPS pension funds and from 1 April 2015, funds were required to introduce local pension boards. The remit of the pension board is to support the pension fund sub-committee in compliance with regulations and with requirements imposed by the pension 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 principles.

**71.** The pension board consists of four employer representatives and four union representatives. The Chair is alternated on an annual basis between the representatives. There have been no requests to review decisions in 2016/17. The pension board and pension fund sub-committee met concurrently throughout 2016/17.

**72.** A key aspect to the operating effectiveness of the pensions board is the retention of knowledge and understanding to support the role.

**73.** A training policy and register of training for committee and board members should be maintained by the Fund detailing a range of training opportunities and time spent training. Our review noted that no policy or register of training has been developed and uptake of training by members has been ad hoc.

### Appendix 1 - point 5

**74.** As the Council is the administering authority for the Fund, the day to day administration of the Fund is carried out by the Pensions Department. The Head of Finance has delegated section 95 responsibility for the Fund.

## Internal audit

**75.** Internal audit provides senior management and members with independent assurance on the Fund's overall risk management, internal control and corporate governance processes.

**76.** Internal audit is provided by the Internal Audit section of Orkney Islands Council. We carried out a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place.

**77.** In 2016/17, internal audit had planned to undertake a review of the pension system migration (the transfer of manual records to Heywood's Pensions Administration system, Altair). However, for the fifth consecutive year, internal audit was unable to carry out this review due to continued migration delays.

### Appendix 1 – point 1

**78.** It was agreed with the Head of Internal Audit that an additional review of pension administration would be carried out and reported prior to sign off of the financial statements. No significant issues identified with the review of pension administration and therefore we have taken assurance over the internal controls operating in the pensions section.

## Other aspects of governance

**79.** We reviewed various other aspects of governance that apply to the Fund including standing orders, financial regulations and arrangements for reporting breaches of regulation to the pensions regulator.

**80.** Overall, we concluded that there are open and transparent arrangements in place.

## Pensions Regulator Public Service Code

**81.** The council reported the Fund's compliance with the Code of Practice 14 (governance and administration of public service pension scheme) to the pensions sub-committee. No breaches were noted.

## Transparency

**82.** Transparency means that the public, in particular members have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using resources.

**83.** There is evidence from a number of sources which demonstrate the Fund's commitment to transparency. For example, the Fund's annual accounts are available on the administering authority's website.

**84.** The Pension fund sub-committee and pensions board meetings are held in public and the minutes of these meetings publicly available on the council's website.

**85.** Overall, we concluded that the Fund conducts its business in an open and transparent manner.

# Part 5

## Value for money



### Main judgements

The Fund's performance is subject to regular review and scrutiny by the pension fund sub-committee. The Fund reviews the value for money that it receives from its investments on an ongoing basis and adequate arrangements are in place through monitoring of investment performance including participation in fee and performance benchmarking surveys.

**Investment manager performance is reported on a quarterly basis to the pension fund sub-committee and pensions board. This is consistent with good practice.**

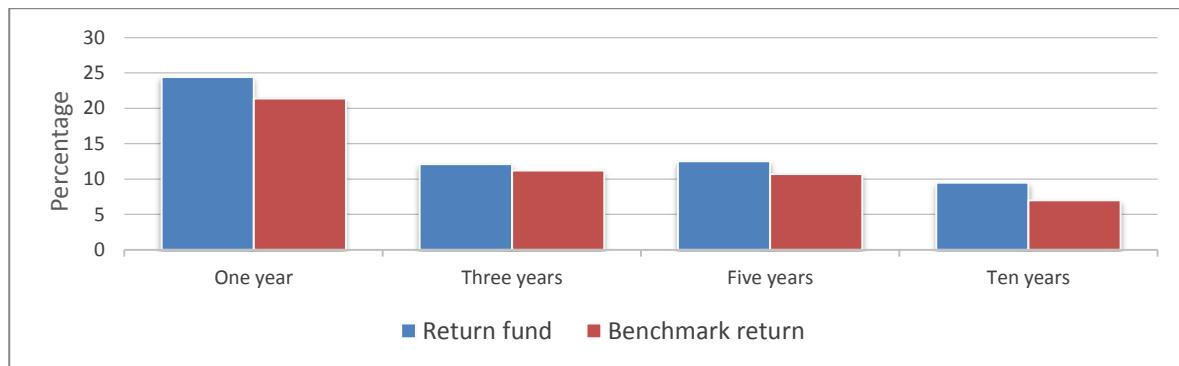
### Investment performance

**86.** The pension fund sub-committee reviews investment performance five times during the year. A review of fund manager's 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.

**87.** Exhibit 9 shows that the Fund's investments outperformed its benchmark in 2016/17 and for the 5 and 10 year period to 31 March 2017 largely due to stock selection by the investment manager (Baillie Gifford). As shown earlier in Exhibit 5 the Fund's net return on investment performance was the best performing fund compared with other LGPS Funds in Scotland.

### Exhibit 9

#### Fund investment performance



Source: Orkney Islands Pension Fund 2016/17 audited financial statements

**88.** Investment manager performance is reported on a quarterly basis to the pension fund sub-committee. The fund overall continues to demonstrate a stable position. Despite rising pension costs, there is a positive cash flow position, with increasing income levels, largely attributable to the increase in the fund's active membership.

### Administrative performance

**89.** 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 the migration project and implementation of Altair (pension administration system).

**90.** Orkney Islands Council Pension Fund has its own standards for its administration performance. In 2016/17, the Fund reported a mixed performance against these standards, with performance improving in only three of its five key service standards (Exhibit 10)

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

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### Exhibit 10 Administration Performance

Category	Performance standard (days)	% processed within standard (15/16)	% processed within standard (16/17)
Pension estimates	10	35.4	30 
Retirement	3	96	93 
Trans in	10	80	88.7 
Trans out	10	55.6	82.4 
Refunds	3	88.9	100 

### Management expenses

**91.** 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.

**92.** CIPFA published revised guidance on local government pension scheme management expenses (LGPS). 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 fund should be included. We have concluded that the Fund complies with new guidance framework.

**93.** Now that the additional information on the cost of LGPS investment management services is available, the Fund should continue to review the level of management expenses. This includes the development of bench-marking information and in the context of returns achieved, to ensure that value for money is being secured.

**94.** External investment manager fees are agreed in the respective mandates governing their appointments. Generally these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments changes.

**95.** Investment management expenses have increased from £0.865m in 2015/16 to £0.938m in 2016/17 which is a small increase compared to the investment return of 24.4% in 2016/17.

**96.** We concluded that the Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

# Appendix 1

## Action plan 2016/17

### 2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
9	<b>1. Migration of Altair Pension System</b> <p>The pace of migration to the Altair system is slow, with only around 75% of membership now transferred since 2012/13.</p> <p>There is a risk that slow migration to the new system increases the inefficiency of service provided to members.</p>	The council requires to increase the pace of migration as a priority.	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 the remaining records should be complete by December 2017.
9	<b>2. Local Code Good Governance Arrangements</b> <p>The requirement in 2016/17, is for the Fund to publicly report on their compliance with their Local Code was not completed.</p> <p>There is a risk that the Fund did not adopt the requirements of the Delivering Good Governance Framework in 2016/17.</p>	The Fund should review compliance against their Local Code and publicly report on this for 2017/18.	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.



Page no.	Issue/risk	Recommendation	Agreed management action/timing
14	<b>3. Internal Control Procedures</b>	<p>The Fund should develop internal control procedures for the new Altair system.</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.</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>		
18	<b>4. Risk Register</b>	<p>The risk register should be reviewed and updated by the pension fund sub-committee and thereafter reviewed annually.</p>	<p>The updated risk register will be presented to the pension fund sub-committee by December 2017.</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 Fund may not identify any new risks or actions to address the current risks.</p>		
19	<b>5. Member Training</b>	<p>A training policy and register of training for committee and board members should be maintained by the Fund.</p>	<p>The Pension Sub Committee adopted a training policy statement in 2015 in line with the Code of Practice on Public Sector Pensions Finance Knowledge and Skills.</p>
	<p>A good induction training programme was provided to all members following the local government elections.</p> <p>However, a training policy and programme require to be developed. Ongoing training and support is important to strengthen the level of scrutiny.</p> <p>There is a risk that members do not have retention of knowledge and understanding to support their role.</p>	<p>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.</p>	<p>Head of Finance March 2018</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 report and 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>		
<b>1 Risk of management override of controls</b>  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.	Detailed testing of journal entries.  Review of accounting estimates.  Evaluation of significant transactions that are outside the normal course of business.	Journals – a sample of journal entries were tested as part of debtors and creditors testing.  Estimates – The significant accounting estimates are provided by third parties, and are not susceptible to management influence. Based on testing of debtors, creditors and provisions/contingencies, we found no evidence of bias in accounting estimates.  Significant transactions – We tested transactions arising from the normal course of business and journal adjustments processed at the year-end. All the reviewed transactions and adjustments were supported by appropriate evidence.

**Conclusion:**  
We found no evidence to suggest that management were overriding controls.

Audit risk	Assurance procedure	Results and conclusions
<p><b>2 Risk of fraud over income and expenditure</b></p> <p>Under ISA 240 there is an inherent risk of fraud over the recognition of revenue. Orkney Islands Council Pension Fund receives investment income from third party sources. This represents a risk due to the extent and complexity of income. ISA240 also extends this risk to misstatement of expenditure.</p>	<p>Evaluating the effectiveness of systems for income recognition and recording.</p> <p>Analytical procedures on income and expenditure streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p> <p>Review service auditor reports.</p>	<p>Controls testing results were satisfactory.</p> <p>We carried out 'reliance on a management expert' work on the actuary in place during the year. We concluded that we could place reliance on the actuary.</p> <p>Analytical procedures were carried out on income and expenditure. This did not identify any issues.</p> <p>Pension contributions were agreed on a sample basis to employer records.</p> <p>Investment income was confirmed to third party confirmation.</p> <p><b>Conclusion:</b> We found no evidence of fraud over income</p>
<p><b>3 Preparation of annual report and accounts</b></p> <p>In 2015/16, changes were required to ensure the annual report and accounts met the requirements of the Code of Practice on local authority accounting in the UK, CIPFA guidance and the Local Authority Accounts (Scotland) Regulations 2014 and other relevant guidance. There is a risk of misstatement in the financial statements if there continues to be an inadequate audit trail between workings and accounts</p>	<p>Ongoing communication with finance staff to ensure they are aware of changes impacting on the 2016/17 financial statements.</p> <p>Review of disclosure checklists.</p> <p>Review of accounts closedown procedures.</p>	<p>An extended trial balance to allow for a clear reconciliation between the ledger balances and investment analysis was prepared. Our review did not identify any significant departures from the requirements of the 2016/17 Code. However, minor presentational and disclosure adjustments were identified.</p> <p><b>Conclusion:</b> The Fund reflected the required changes in the final version of the accounts.</p>
<p><b>4 Changes to financial reporting</b></p> <p>There are changes to the accounting code for 2016/17 financial statements:</p> <p>Presentation changes to the format of the pension fund account.</p> <p>Application of IFRS 13 Fair Value measurement has been applied to pension fund investments</p> <p>New recommended disclosures in respect of management expenses.</p>	<p>Communication of technical changes with officers.</p> <p>Review disclosures as part of our financial statements audit.</p>	<p>Our review did not identify any significant departures from the requirements of the 2016/17 Code. However, minor presentational and disclosure adjustments were identified.</p> <p><b>Conclusion:</b> The Fund reflected the required changes in the final version of the accounts.</p>

Audit risk	Assurance procedure	Results and conclusions
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p><b>5 Altair pension system</b></p> <p>In previous years, the Altair ICT system has been increasingly used to record member entitlements and to perform calculations. However, the pace of migrating information to the new system remains slow, reducing the efficiency of service provided to members.</p>	<p>Ongoing communication with pension staff to ensure that migration exercise is completed.</p>	<p>The pace of migration to the Altair system is slow, with only around 75% of membership now transferred. Priority is given to members with status changes where calculations are made. The Council plans to upload the remaining members during 2017/18.</p> <p><b>Conclusion:</b></p> <p>The Fund requires to increase the pace of migration as this represents a reduction in the efficiency of service to the Fund's members.</p>
<p><b>6 Local elections</b></p> <p>There may be changes to the composition of the Orkney pension board and the pensions fund sub-committee as a result of the local government elections in May 2017. There is a risk that, following the elections, a number of new members do not have the necessary experience and understanding of their role and responsibilities in such areas as governance, scrutiny and decision making.</p>	<p>We will monitor the council's arrangements for developing members and preparations for inducting newly elected members.</p>	<p>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.</p> <p><b>Conclusion</b></p> <p>The Fund plan to develop a training policy and programme during 2017/18.</p>

# Orkney Islands Council Pension Fund

## 2016/17 Annual Audit Report

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