# External Audit Plan

**For the year ended 31 March 2023**

**Orkney Islands Council Pension Fund**

**10 May 2023**

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# 1 Introduction

**To the Trustee Board of the Orkney Islands Council Pension Fund**

I am pleased to have the opportunity to present our external audit plan ahead of the meeting on 18 May 2023 in relation to the audit of the financial statements of Orkney Islands Council Pension Fund, as at and for the year ended 31 March 2023.

This report, which outlines our risk assessment and planned audit approach is being provided to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

Our audit plan incorporates key changes required as a result of changes to both International Auditing Standard (ISA) UK 315:Identifying and assessing the risks of material misstatement and ISA 240:The auditors responsibilities relating to Fraud.

## 1.1 The engagement team

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

Other key members of the engagement team include Jillian McDonald as engagement manager. She has more than 20 years of industry experience. Jillian will be responsible for overseeing the delivery of our audit.

Yours sincerely,

Julie Radcliffe

Engagement Director

10 May 2023

## 1.2 How we deliver audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion that is also important.

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

- **Executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls**; and

- All of our related activities are undertaken in an environment of the utmost level of **objectivity**, **independence**, **ethics** and **integrity**.

## 1.3 About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland’s Code of Audit Practice (“the auditing Code”).

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

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

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

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

## 1.4 Complaints

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

# 2 Impact of new auditing standards

## 2.1 Impact of new auditing standards on our audit approach

Our audit plan incorporates key changes required as a result of changes to the following International Auditing Standards, which come into force for the 31 March 2023 audit.

### 2.1.1 ISA 315 (UK) Revised: Identifying and assessing the risks of material misstatement

ISA (UK) 315 incorporates significant changes from the previous version of the ISA, in order to achieve a more rigorous risk identification and assessment process. To meet the requirements of this new standard, we will have spent an increased amount of time on risk assessment. While the changes to the standard are significant, the key impacts on our approach at Orkney Islands Council Pension Fund have been as follows:

- **More granular risk assessment procedures** and documentation of risks of material misstatement e.g. significant risk over completeness of specific elements of non-pay expenditure;
- **Increased focus on the IT environment**, including the IT applications and supporting IT infrastructure, the IT processes and personnel running them;
- **Evaluation of the design and implementation of general IT controls** (automated controls) supporting journal entry processing including system access, automated segregation of duties etc

### 2.1.2 ISA 240 The auditors responsibilities relating to Fraud

ISA (UK) 240 *The auditor's responsibilities relating to fraud in an audit of financial statements* includes revisions introduced to clarify the auditor's obligations with respect to fraud and enhance the quality of audit work performed in this area. The changes are not as extensive as ISA 315 Revised, but have had the following impact on your audit:

- **Increased focus on applying professional scepticism**
- **Requirement to perform inquiries with individuals at the entity are expanded to include, amongst others, those who deal with allegations of fraud.**
- **Specific determination as to whether to involve technical specialists** (including forensics) to aid in identifying and responding to risks of material misstatement due to fraud.

Further detail on these new standards is set out in Appendix 9.

# 3 Materiality

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

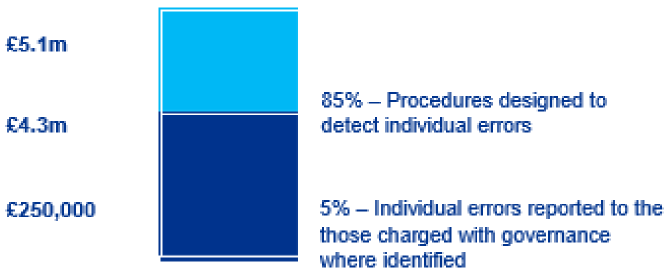
Materiality is set within a range deemed appropriate by the Audit Director – this is typically a percentage of total assets (0.5 - 3.0%) for pension schemes.

We have set materiality level for the Fund to £5.1m (based on the total assets as at 31 March 2022) which is 1% of estimated total assets, as illustrated below. We have used total assets as the benchmark to determine materiality as this is a key performance indicator used by the user of the Fund's financial statements. We consider 1% to be the appropriate materiality level, as the Fund is operating in a relatively stable business environment, has a viable sustainable business model and has no external debt.

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

**Total Assets as at 31 March 2022 £509m**

**Materiality (1% of total assets £5.1m)**



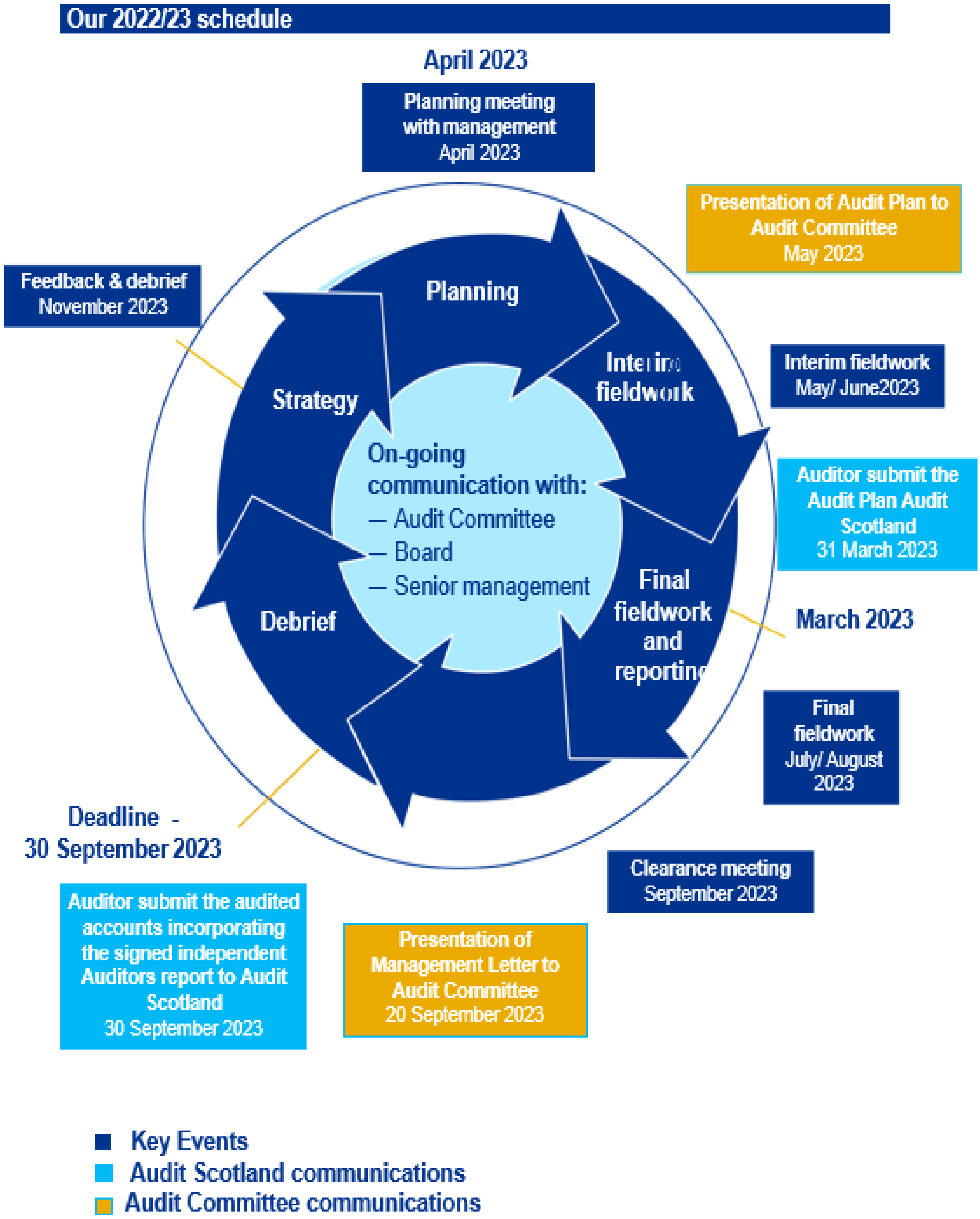

Whilst our audit procedures will be designed to identify misstatements (including disclosure misstatements) which are material to our opinion on the financial statements as a whole, we nevertheless report to those charged with governance any misstatements of lesser amounts to the extent that these are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

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

To comply with auditing standards, all differences greater than £250,000 are required to be presented to those charged with governance.

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

# 4 Audit cycle and timetable



# 5 Audit Summary

## 5.1 Financial Statement Audit

We have commenced our audit planning and risk assessment procedures and have identified the following risks on which we will focus our work.

As our planning and risk assessment continues, these may be updated

| Significant risks | Page |
|---|---|
| **Management override of controls (presumed Significant Risk)** | 10 |
| **Other audit risks** | |
| Incorrect valuation of Levels 1, 2 & 3 investments | 11 |
| Inaccurate or late contributions | 13 |
| Misstatement of cash | 15 |
| Investment return misstated | 16 |
| Incorrect benefit payments | 17 |
| Presentation of financial statements | 18 |

## 5.2 Wider Scope Audit

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

- Financial Management
- Financial Sustainability
- Vision, Leadership and Governance
- Use of Resources to Improve Outcomes
- Climate Change
- Cyber Security

From the work performed so far we have not identified any significant risks in relation to these areas. See Wider Scope risk assessment at pages 16-20.

# 6 Audit risks and our audit approach

## Presumed Significant Risk

## 6.1 Management override of controls

### 6.1.1 The Risk

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

### 6.1.2 Planned Response

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

Our audit methodology incorporates the risk of management override of controls as a default significant risk.

Assess accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.

Evaluate the selection and application of accounting policies.

In line with our methodology, we will evaluate the design and implementation of controls over journal entries. In view of the revision to ISA 315, in the current year this also mandates reviewing the design and implementation of automated controls used in the financial reporting process, where automated controls are in place.

In regards to the financial reporting and journals process, we will perform the following over journal entries and other adjustments :

- We will consider any high risk criteria underpinning specific journals to test substantively. If any journals meet this criteria, we will audit each journal individually as part of our year-end audit process.
- Evaluate the completeness of the population of end of reporting journal entries.
- Identify and test items in the population of end of reporting journal entries based on our professional judgement.

## Other audit risks

## 6.2 Incorrect valuation of Levels 1,2, and 3 Investments

### 6.2.1 The Risk

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

### 6.2.2 Planned Response

As part of our audit procedures we will gain an understanding of the processes over the valuation of Level 1, 2 and 3 investments.

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

We will gain an understanding of the control environment at all the investment managers and custodian by reviewing their internal controls reports to identify any control deficiencies that would impact our audit approach.

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

#### 6.2.2.1 Segregated financial instruments

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

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

We will verify the pricing of the pooled investment vehicles at the year to an external pricing source (where available), We will also reconcile the closing unit holdings based on audited prior period position and purchases and sales transactions reported by the investment managers.

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

- We will obtain direct confirmation from the pooled investment managers at the year end confirming valuation and holdings.

- We will also reconcile the closing unit holdings based on audited prior period position and purchases and sales transactions reported by the investment managers.

- We will gain an understanding of the control environment at the investment managers by reviewing their internal controls reports to identify any control deficiencies that would impact our audit approach.

- We will obtain and review the latest audited financial statements for the underlying funds where available:

- We will review the audit report to confirm that it is unqualified and that the audit has been carried out by a reputable audit firm: and

- We will compare the unaudited pricing information at the year end to the audited financial statements valuation. Where the audited financial statements are not as at the Scheme year end date, we will agree them to unaudited pricing information at that date and reconcile significant movements to the Scheme year end date.

## 6.3 Inaccurate or late contributions

### 6.3.1 The Risk

- Inaccurate or late contributions

- Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. Revenue in a pension scheme equates to contributions receivable. Contributions relate to the actual amounts paid or due to be paid under an agreed schedule, plus other amounts as determined by the Trustee(s). This revenue is recognised based on specific instructions as set out in the appropriate schedule(s). There are no subjective issues concerning when contributions need to be recognised. Amounts involved cannot easily be manipulated through accounting policies, issue of credit notes, timing or other policies. There is little incentive for the Trustee(s) to manipulate the financial reporting of contributions. Therefore, in the absence of specific fraud risk factors, the presumption that fraudulent revenue recognition is a significant risk is rebutted for pension scheme audits.

### 6.3.2 Planned Response

As part of our audit procedures we will gain an understanding of the processes over the contribution payment arrangements between the sponsoring employer and the Pension Fund and also the effectiveness of the contribution monitoring arrangements. As part of risk assessment procedures, for a member file, we will perform walkthrough procedures and carry out a re-performance check on normal employee and employer contributions by reference to their pensionable salary and rates. (if appropriate).

Our audit procedures over contributions will include:

- Verifying that all contributions are received into the Scheme on a timely basis under the LGPS requirements.

- Calculating an expectation of the normal employer and employee contributions receivable in the year reflecting changes in active members in the year, increases in pensionable salary and any changes in the contributions rates in the year;

- Ensuring that there are 12 months receipts in the year and assessing the trend of such receipts;

- Agreeing active members per the membership statistics to the number of active members paying contributions in the final month's remittance statements and the amount received per the nominal ledger to the final month's remittance statement from the employer;

- Ensuring that Strain Costs are received in line with agreed amounts.

## 6.4 Misstatement of Cash

### 6.4.1 The Risk

Misstatement of Pension Fund Cash at bank

### 6.4.2 Planned Response

Our audit will include:

- Obtain the bank confirmation directly from the bank.
- Compare audited entity balances with the bank reconciliation provided by the administrator and the bank confirmation received directly from the bank.
- Obtain the bank reconciliation (where there are reconciling items) and test any significant reconciling items.

## 6.5 Change in market value and/or investment income misstated

### 6.5.1 The Risk

Change in market value and/or investment income misstated

### 6.5.2 Planned Response

Our audit will include:

- Agree sales and purchases per the investment reconciliation to investment manager/custody reports;
- Agree opening and closing investment balances to investment manager statements;
- Agree investment income to investment manager reports/ custodian reports and/or bank statements, where material;
- Agree cash received/paid through to the Fund accounting records; and
- Agree the overall investment return stated in the Annual report for consistency with the amounts reported in the financial statements

## 6.6 Incorrect benefit payments

### 6.6.1 The Risk

Incorrect benefit payments

### 6.6.2 Planned Response

Our audit procedures over pension payments will include:

- Calculating an expectation of the amounts payable in the year reflecting changes in pensioner numbers in the year and the annual pension increase applied;
- Ensuring that there are 12 months pension payments in the year and assessing the trend of such payments;
- Agreeing pensioners per the membership statistics to the number of pensioners paid per the final month's pensioner payroll and the amount paid per the nominal ledger to the final month's pensioner payroll.

Our audit procedures over benefit payments and transfers will include:

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

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

- Agreeing the documentation from the member file and the resulting benefit payment produced by the administrator to the payment made per the cash book;
- Ensuring that there was an evidence of peer review/check of the calculation by a more senior member of the administration team /calculation checked by the actuary (where applicable);
- Reviewing member correspondence to ensure that the benefit paid was in line with the request of the member; and
- Specifically for transfers out also ensuring that the actuary had provided approval (where required) and reviewing correspondence to check that the receiving scheme was an approved pension scheme

In addition where we assess that any benefit payments or transfers are individually material, for those benefits and /or transfers out we will use our pensions administration specialists. Within the scope of their work they will consider the accuracy of the calculations on an individual basis as per the rules of the Fund.

## 6.7 Incorrect financial statement presentation

### 6.7.1 The Risk

Incorrect financial statement presentation

### 6.7.2 Planned Response

Our audit will include completion of our financial statement disclosure checklist, which takes account of the requirements of the Pensions SORP (revised 2018), FRS 102 and pensions legislation. The checklist also covers “Other information”.

“Other information” relates to statements such as the Management Commentary, the Remuneration Report, Annual Governance Statement, Governance Compliance Statement and other reports included in the annual report other than the financial statements and the auditor’s report thereon. For the purposes of our audit “Other information” is covered by ISA (UK)720 The Auditor’s Responsibilities Relating to Other Information, and as such our responsibilities over the disclosures made are similar to those over the content of the Trustee’s Report.

Other information is read and checked for consistency with the financial statements and our knowledge gained throughout the audit process. As auditor, we will look for material inconsistencies, but we will not verify any of the detailed disclosures.

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

# 7 Wider scope and best value

Appointed auditors are required to consider the areas defined in the Code of Audit Practice (2021) as wider-scope audit.

Auditors should consider these additional requirements when:

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

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

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

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

The four wider-scope areas are briefly defined and the areas of focus and current position with the Risk Assessment work.

- Financial Management – Page 17;
- Financial Sustainability – Page 17;
- Vision, Leadership and Governance – Page 18; and
- Use of Resources to Improve Outcomes – Page 18 In addition to the four wider scope for 2022/23 Audit Scotland have also mandated that for their National Risk Assessment all bodies are assessed for:
- Climate Change – Page 19.
- Cyber Security– Page 20.

## 7.1 Reporting within the Annual Audit Report

We will report on the four wider scope areas and Climate change within the Annual Audit Report, and we are required to provide clear judgements and conclusions on the effectiveness and appropriateness of the arrangements in place based on the work that they have done. Where significant risks are identified we will make recommendations for improvement. The Annual audit reports will include conclusions which are retrospective in nature, comment on progress in implementing previous recommendations and on forward plans within aspects of the wider scope requirements.

## 7.2 Financial Management

### 7.2.1 Scope

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

### 7.2.2 Areas of Focus

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

### 7.2.3 Risk Assessment

From the work performed so far we have not identified any significant risks in relation to these areas.

## 7.3 Financial Sustainability

### 7.3.1 Scope

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

### 7.3.2 Areas of Focus

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

### 7.3.3 Risk Assessment

From the work performed so far we have not identified any significant risks in relation to these areas.

## 7.4 Vision, Leadership and Governance

### 7.4.1 Scope

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

### 7.4.2 Areas of Focus

- the vision and strategy of the Pensions Committee, to ensure it includes a clear set of priorities which reflects the pace and depth of improvement that is need to realise the Pension Funds priorities and long term sustainability of services to meet the needs of the members

- the governance arrangements are appropriate and operating .

- assess the evidence that demonstrates leaders are adaptive to the changing environment

- the culture of the Board and how it operates with partners to understand their roles and responsibilities to help deliver the priorities of all partners

### 7.4.3 Risk Assessment

From the work performed so far we have not identified any significant risks in relation to these areas.

## 7.5 Use of Resources to Improve Outcomes

### 7.5.1 Scope

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

### 7.5.2 Areas of Focus

- The arrangements in place to demonstrate that there is a clear link between money spent and outputs and the outcomes delivered

- The arrangements to evaluate service delivery and quality and whether the user needs and views are included in any such evaluation

### 7.5.3 Risk Assessment

From the work performed so far we have not identified any significant risks in relation to these areas.

## 7.6 Climate Change

### 7.6.1 Background

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

There are specific legal responsibilities placed on public bodies to contribute to reducing greenhouse gas emissions, to adapt to climate change, to act sustainably and to report on progress. A number of public bodies have declared a climate emergency and set their own net zero targets, some of which are earlier than Scotland's national targets. All public bodies will need to reduce their direct and indirect emissions, and should have plans to do so. Many bodies will also have a role in reducing emissions in wider society, and in supporting activity to adapt to the current and potential future impact of climate change. For example, working with the private sector and communities to help drive forward the required changes in almost all aspects of public and private life, from transport and housing to business support.

Public audit has an important and clear role to play in:

- helping drive change and improvement in this uncertain and evolving area of work
- supporting public accountability and scrutinising performance
- helping identify and share good practice

### 7.6.2 2022-23 Audit Requirements

We are required to provide answers to a standard set of questions Audit Scotland have mandated. This is intended to gather information on the arrangements for responding to climate change in each body.

### 7.6.3 Reporting

We will be required to report the responses to the questions to Audit Scotland in a formal return, and we will also provide a commentary on the findings in the Annual Audit Report.

## 7.7 Cyber Security

### 7.7.1 Background

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

### 7.7.2 2022-23 Audit Requirements

For 2022/23 audits, auditors are advised to consider risks related to cyber security at audited bodies. The revised ISA (UK) 315 includes enhanced requirements for auditors to understand a body's use of IT in its business, the related risks and the system of internal control addressing such risks. The Auditor General and Accounts Commission consider that meeting these additional requirements is likely to be sufficient consideration of cyber security in 2022/23. Audit Scotland continues to monitor cyber security arrangements at a national and local level on behalf of the Auditor General and Accounts Commission

### 7.7.3 Reporting

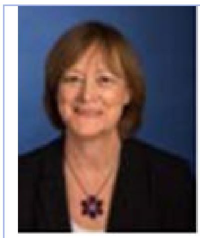
We will report any significant incidents, issues or areas of good practice that we identify to Audit Scotland's Digital Audit team.

# 8 Mandatory Communication (Appendix One)

| Type | Statement |
|---|---|
| Management's responsibilities (and, where appropriate, those charged with governance) | Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error. Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity. |
| Auditor's responsibilities | Our engagement letter issued by Audit Scotland on 18 May 2022 and signed by KPMG on 14 April 2023 communicates our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. |
| Auditor's responsibilities - Fraud | This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit. |
| Auditor's responsibilities – Other information | Our engagement letter issued by Audit Scotland on 18 May 2022 and signed by KPMG on 14 April 2023 communicates our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information. |
| Auditor's responsibilities – wider scope | Our wider scope slide on page 16 onward sets out our responsibilities for reporting on the Board's arrangements for the 6 wider scope areas. No significant wider scope risks have been identified. |
| Independence | Our independence confirmation on page 25 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff. |

# 9 Audit Team and Rotation (Appendix Two)

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

| | |
|---|---|
|  | **Julie Radcliffe is the director responsible for our audit. She will lead our audit work, attend the Audit Committee and be responsible for the opinions that we issue.** |
|  | Jillian McDonald is the manager responsible for our audit. Jillian will be responsible for managing the day-to-day co-ordination and delivery of the audit, liaising with management and supervising the work of the audit team. |

**We include in our team:**

Our iRADAR team, will review the valuation of the equities held to identify any potential material pricing issues.

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

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

This will be Julie's 1st year as your engagement lead. She can therefore complete a further 9 years before rotation. Audit Scotland will tender provision of audit services after 5 years.

# 10 Audit Fees (Appendix Three)

Audit Scotland has completed a review of funding and fee setting arrangements for 2022-23. An expected fee is calculated by Audit Scotland to each entity within its remit. This expected fee is made up of four elements:

- Auditor remuneration, pooled costs, contribution to Audit Scotland costs, sectoral adjustment

The expected fee for each body assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for the audit. We are in discussions with management regarding the auditor remuneration for 2022-23. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise including any requirement to consider accounting for, or auditing grants, we will discuss with management the impact of this on our proposed fee. The following table summarises the expected fee determined by Audit Scotland which can be subject to variation based on discussion and agreement between auditor and audited body.

We will discuss such variation with management in respect of first year audit procedures.

| Orkney Islands Council Pension Fund | Inc VAT 2022/23 |
|---|---:|
| Auditor Remuneration | 40,910 |
| Pooled Costs | - |
| Audit Support | 1,550 |
| Sectoral Cap Adjustment | -17,600 |
| **TOTAL Fees** | 24,860 |

## 10.1 Basis of fee information

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

- The Fund's audit evidence files are completed to an appropriate standard (we will liaise with management separately on this);
- Draft statutory accounts are presented to us for audit subject to audit adjustments;
- Supporting schedules to figures in the accounts are supplied;

A trial balance together with reconciled control accounts are presented to us;

- All deadlines agreed with us are met;
- We find no weaknesses in controls that cause us to significantly extend procedures beyond those planned;
- Management will be available to us as necessary throughout the audit process; and
- There will be no changes in deadlines or reporting requirements.

We will provide a list of schedules to be prepared by management stating the due dates together with pro-forms as necessary. Our ability to deliver the services outlined to the agreed timetable and fee will depend on these schedules being available on the due dates in the agreed form and content.

If there are any variations to the above plan, we will discuss them with you and agree any additional fees before costs are incurred wherever possible.

# 11 Confirmation of independence (Appendix Four)

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

To the Audit Committee members

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

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

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

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

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

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

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

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

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

| 2022/23 (to date) | |
|---|---|
| Audit of Board | 25 |
| **Total audit** | |
| **Total non-audit services** | 0 |
| **Total Fees** | **25** |

## 11.2 Confirmation of audit independence

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

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

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

Yours faithfully

KPMG LLP

# 12 Responsibility in relation to fraud (Appendix Five)

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

## 12.1 Management responsibilities

Adopt sound accounting policies.

With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.

Establish proper tone/culture/ethics.

Require periodic confirmation by employees of their responsibilities.

Take appropriate action in response to actual, suspected or alleged fraud.

Disclose to Monitoring and Audit Committee and auditors:

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

## 12.2 KPMG's identification of fraud risk factors

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

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

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

## 12.4 KPMG's identified fraud risk factors

- Whilst we consider the risk of fraud at the financial statement level to be low for the Council, we will monitor the following areas throughout the year and adapt our audit approach accordingly:
- Cash
- Procurement.
- Management control override; and
- Assessment of the impact of identified fraud.

# 13 Audit Outputs (Appendix Six)

| Output | Description | Report date |
|---|---|---|
| Annual Audit Plan | Our strategy for the external audit of the Board including significant risk and other audit areas. | By 17 May 2023 |
| Independent auditor’s report | This report will contain our opinion on the financial statements, the audited part of the remuneration and staff report, governance statement and performance report. | By 30 September 2023 |
| Annual audit report | We summarise our findings from our work during the year. | By 20 September 2023 |

# 14 Audit Scotland code of audit practice – responsibility of auditors and management (Appendix Seven)

## 14.1 Responsibilities of management

### 14.1.1 Financial Statements

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

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

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

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

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

### 14.1.2 Prevention and detection of fraud and irregularities

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

### 14.1.3 Corporate governance arrangements

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

### 14.1.4 Financial position

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

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

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

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

## 14.2 Responsibilities of auditors

### 14.2.1 Appointed auditor responsibilities

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

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

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

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

### 14.2.2 General principles

This Code is designed such that adherence to it will result in an audit that exhibits these principles.

#### 14.2.2.1 Independent

When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.

Our independence confirmation letter (**Appendix four**) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.

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

#### 14.2.2.2 Proportionate and risk based

Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self - evaluation evidence when assessing and identifying audit risk.

#### 14.2.2.3 Quality focused

Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

#### 14.2.2.4 Coordinated and integrated

It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.

### 14.2.2.5 Public focused

The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm's-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.

### 14.2.2.6 Transparent

Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.

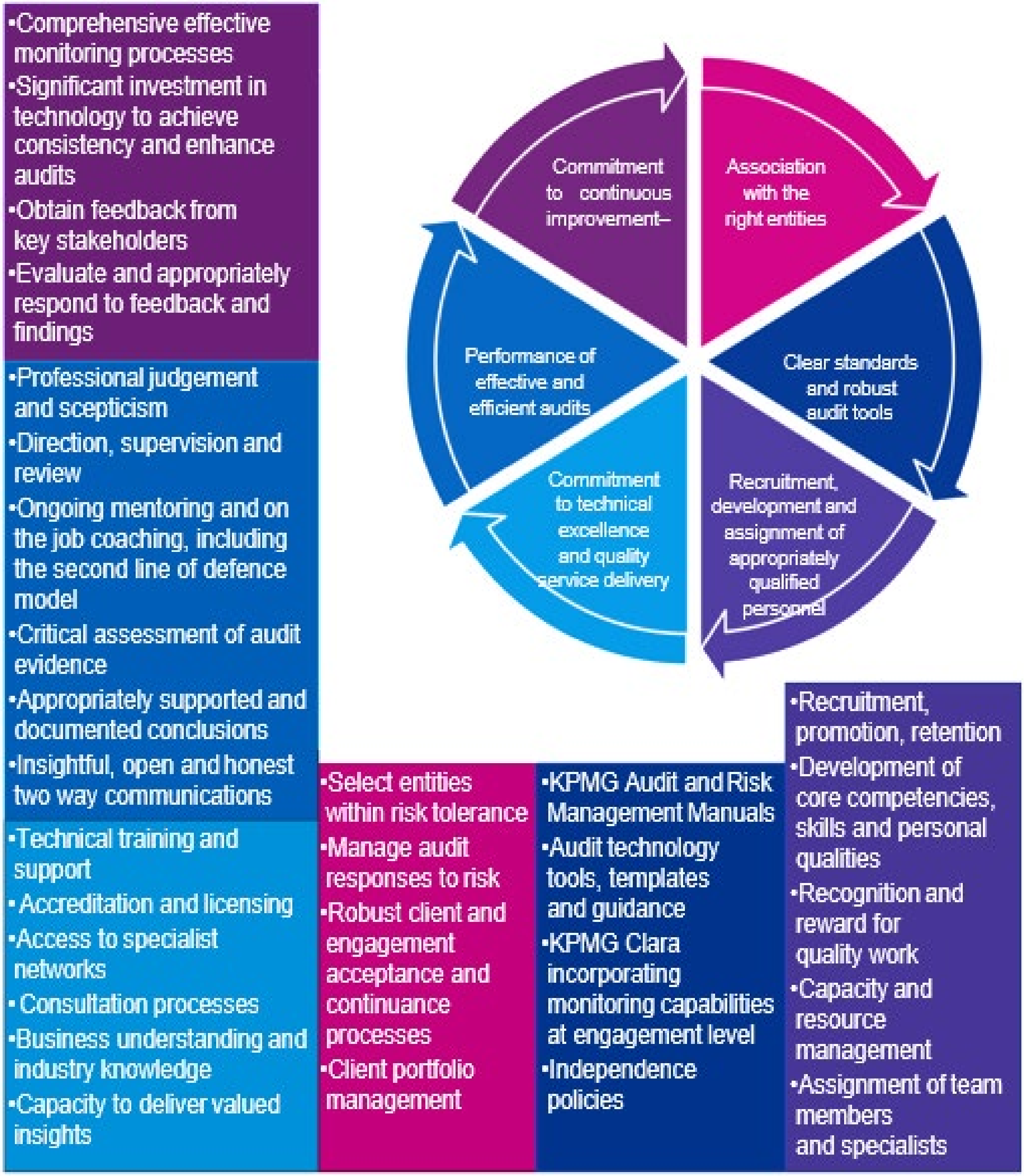
### 14.2.2.7 Adds value

It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement w here significant risks are identified.

# 15 KPMG’s Audit Quality (Appendix Eight)

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

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



# 16 ISA (UK) 315 Revised: Overview (Appendix Nine)

## 16.1 Summary

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

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

### 16.1.1 Why have these revisions been made?

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

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

### 16.1.2 What does this mean for an audit?

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


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

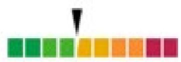
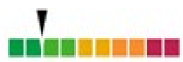
# 17 Impact of new standards - ISA (UK) 240 Revised (Appendix Ten)

## 17.1 Summary and background

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

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

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


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

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