

# Orkney Islands Council Pension Fund

Annual Audit Plan 2018/19



 AUDIT SCOTLAND

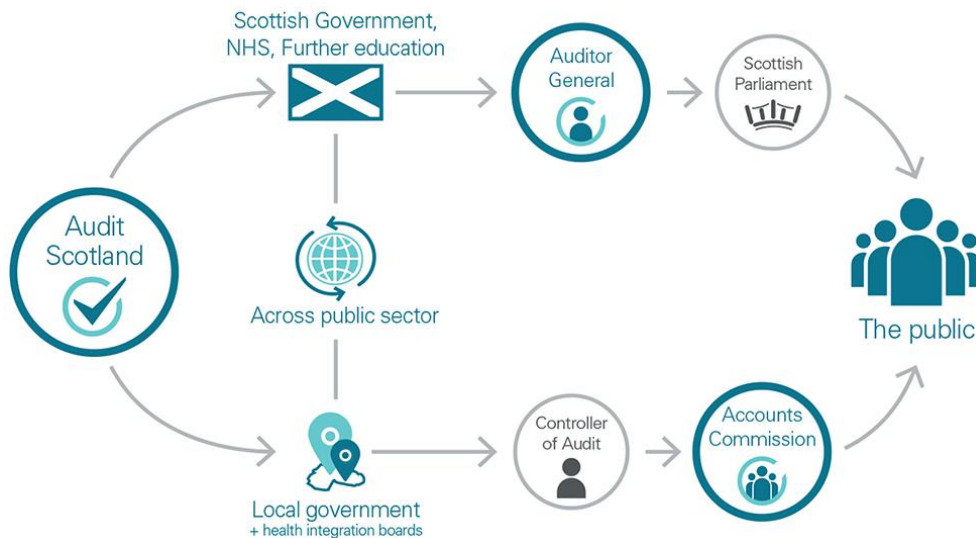
Prepared for Orkney Islands Council Pension Fund Sub Committee and Pensions Board

February 2019

## 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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# Risks and planned work

1. Our audit of the Orkney Islands Council Pension Fund (the Fund) is carried out in accordance with the Code of Audit Practice, International Standards on Auditing (ISAs), and other relevant guidance. This plan contains an overview of the planned scope and timing of our audit. It sets out the work necessary to allow us to provide an independent auditor's report on the financial statements and to meet the wider scope requirements of public sector audit.

2. The wider scope of public audit contributes to assessments and conclusions on financial management, financial sustainability, governance and transparency, and value for money.


## Adding value


3. We aim to add value to the Fund through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we intend to help the Fund promote improved standards of governance, better management, and decision making, and more effective use of resources.


## Audit risks

4. Building on our knowledge from previous years, discussions with staff, attendance at committee meetings and a review of supporting information we have identified a number of key financial and wider dimension audit risks. These risks are detailed in [Exhibit 1](#).

## Exhibit 1 2018/19 Key audit risks

 Audit Risk	Source of assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p>1 <b>Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<ul style="list-style-type: none"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates.</li> <li>Focused testing of accruals and prepayments.</li> <li>Evaluation of significant transactions that are outside the normal course of business.</li> </ul>
<p>2 <b>Risk of fraud over income and expenditure</b></p> <p>ISA 240 presumes a risk of fraud over income; this is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and</p>	<p>Effective budget monitoring and reporting by management.</p>	<ul style="list-style-type: none"> <li>Evaluation of the effectiveness of systems for income recognition and recording.</li> <li>Review of custodian arrangements and</li> </ul>

	Audit Risk	Source of assurance	Planned audit work
	<p>the Financial Reporting Council's <a href="#">Practice Note 10 (revised)</a>.</p> <p>The Fund receives a significant amount of income from third party sources. This presents a risk due to the extent and complexity of income.</p> <p>The Fund also makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.</p>		<p>completion of 'review of work by service auditors' in accordance with ISA 402 for the global custodian.</p> <ul style="list-style-type: none"> <li>Analytical procedures on income and expenditure streams.</li> <li>Agree income to third party confirmation.</li> <li>Substantive testing of expenditure.</li> <li>Evaluation of progress in relation to the 2018/19 National Fraud Initiative.</li> </ul>
3	<p><b>Estimation, judgements and Classification</b></p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments and the actuarial valuation. Investments include investments such as pooled funds, where valuations involve the application of judgement in determining appropriate amounts.</p>	<p>Prices are collected by the Fund Manager from a number of sources and this data is checked via an automated data cleansing system with exception checking performed by a dedicated market data team.</p> <p>Investments listed on Stock Exchanges are included at their official closing price on the last business day of the reporting period.</p> <p>Suspended, liquidated, and unquoted stocks may be referred to the Fair Value Pricing Group for consideration. The Fair Value Pricing Group will determine the appropriate valuation methodology.</p> <p>Holdings in Baillie Gifford pooled funds are valued at month end using a single price which reflects closing prices of the underlying assets in the funds.</p>	<ul style="list-style-type: none"> <li>Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.</li> <li>Confirmation of valuations to valuation reports and/ or other supporting documentation.</li> <li>Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary.</li> <li>Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2018/19.</li> </ul>
	<p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions. This subjectivity entails a risk of misstatement in the financial statements.</p>	<p>The Council engaged extensively with the Pension Fund Actuary in preparation for the 2017 Triennial Valuation of the Pension Fund. The actuary was asked to run modelling projections of the Fund's contribution strategy to help in the selection of an asset outperformance assumption; and also performed modelling of salary increase assumptions to give comfort that the assumptions adopted are justified and based of real evidence.</p>	

	Audit Risk	Source of assurance	Planned audit work
<b>Wider dimension issues</b>			
4	<p><b>Internal Control Procedures</b> During 2017/18, the pension fund have migrated all records to the Altair ICT system which is used to record member entitlements and to perform some calculations.</p> <p>With the new system and more staff now working on pensions there is an opportunity to develop new internal controls procedures for the Altair system to reduce the risks of errors and provide the opportunity for independent checks by more staff.</p>	<p>An authorisation and approvals hierarchy will be developed during 2018/19 for the Altair system so that the segregation of duties can be followed and evidenced on working papers.</p> <p>The extent to which segregation can be practically implemented is however restricted due to the very small size of the pension team.</p>	<ul style="list-style-type: none"> <li>Review the funds authorisation and approvals hierarchy.</li> </ul>

Source: Audit Scotland

## Reporting arrangements

5. Audit reporting is the visible output for the annual audit. All annual audit plans, and the outputs as detailed in [Exhibit 2](#) and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

6. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officer(s) to confirm factual accuracy.

7. At the end of our audit we will provide the Orkney Pension Fund sub-committee and the Accounts Commission with an annual audit report containing observations and recommendations on significant matters which have arisen during the audit. We will also issue an independent auditor's report containing our opinion on the financial statements.

## Exhibit 2 2018/19 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	15 February 2019	27 February 2019
Annual Audit Report	6 September 2019	17 September 2019
Independent Auditor's Report	17 September 2019	17 September 2019

Source: Audit Scotland

## Audit fee

8. The proposed audit fee for the 2018/19 audit of the Fund is £20,560 (2017/18: £19,970). In determining the audit fee, we have taken account of the risk exposure of the Fund, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited annual accounts, with a complete working papers package on 17 June 2019.

**9.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual accounts or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises out with our planned audit activity.

## Responsibilities

### Pension Fund Sub-Committee

**10.** Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance that enable them to successfully deliver their objectives.

**11.** The audit of the annual accounts does not relieve management or the Pension Fund Sub-Committee as those charged with governance, of their responsibilities.

### Appointed auditor

**12.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice (including supplementary guidance) and guided by the Financial Reporting Council's Ethical Standard.

**13.** Auditors in the public sector give an independent opinion on the financial statements and other information within the annual accounts. We also review and report on the arrangements within the audited body to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

# Audit scope and timing

## Annual report and accounts

14. The audit of the Annual report and accounts, including the financial statements, will be the foundation and source for most of the work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of the Fund and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how the Fund will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free from material misstatement.

15. We will give an opinion on whether the financial statements:

- give a true and fair view of the financial transactions of the fund during the year ended 31 March 2019 and the amount and disposition as at that date of its assets and liabilities
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as interpreted and adopted by the Code of Practice on Local Authority Accounting in the UK and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.



## Other information in the annual accounts

16. We review and report on other information published within the Annual report and accounts including the management commentary, annual governance statement and the governance compliance statement. We give an opinion on whether these statements have been compiled in accordance with the appropriate regulations and frameworks in our independent auditor's report.

17. We also review the content of the pension fund annual report for consistency with the financial statements and with our knowledge. We consider whether the information is otherwise materially misstated. We are not required to consider the wider compliance of the annual report with regulatory requirements.

## Materiality

18. We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinions in the independent auditor's report.



19. We calculate materiality at different levels as described below. The calculated planning materiality values for the Fund are set out in [Exhibit 3](#).

### Exhibit 3 Materiality values

Materiality	Fund name
<b>Planning materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 1% of net assets for the year ended 31 March 2019 based on the latest audited accounts for 2017/18.	£3.664 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 planning materiality.	£1.832 million
<b>Reporting threshold (clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 2.5% of planning materiality.	£100 thousand

Source: Audit Scotland

#### Lower specific materiality

20. In addition to planning materiality we set lower, specific materiality levels for certain classes of transaction, account balances or disclosures where lesser amounts could influence the decisions of the users of the accounts.

21. We recognise that transactions with contributions receivable are of importance to the users of the accounts and we set specific materiality levels as shown in [Exhibit 4](#).

### Exhibit 4 Lower specific materiality values

Materiality	Fund name
<b>Specific materiality</b> – It has been set at 10% of benefits payable based on the latest audited accounts for 2017/18.	£793 thousand
<b>Specific performance materiality</b> – Using our professional judgement we have calculated performance materiality at 50% of the specific materiality.	£396 thousand million



Source: Audit Scotland

#### Timetable

22. To support the efficient use of resources it is critical that an annual report and accounts timetable is agreed with us to produce the unaudited accounts. We have included an agreed timetable at [Exhibit 5](#).

## Exhibit 5

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited annual accounts by those charged with governance	By 31 August 2019
Latest submission date of unaudited annual accounts with complete working papers package	17 June 2019
Latest date for final clearance meeting with Pensions Manager and Head of Finance	25 August 2019
Agreement of audited unsigned financial statements; Issue of Annual Audit Report including ISA 260 report to those charged with governance	17 September 2019
Independent auditor's report signed	By 30 September 2019

Source: Audit Scotland

### Internal audit

**23.** Internal audit is provided by Orkney Islands Council Internal Audit section overseen by a Chief Internal Auditor. As part of our planning process we carry out an annual assessment of the internal audit function to ensure that it operates in accordance with Public Sector Internal Audit Standards (PSIAS).

**24.** We carried out an early assessment of the internal audit function and concluded that it has sound documentation standards and reporting procedures in place and complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).

### Using the work of internal audit

**25.** We do not plan to place reliance on internal audit's work for our 2018/19 financial statements audit. The scope of the internal audit work will not reduce the level of our audit testing in support of our audit opinion on the financial statements. We will however take account of internal audit's findings to inform our wider Code responsibilities.

### Audit dimensions

**26.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 6](#).

## Exhibit 6

### Audit dimensions



Source: Code of Audit Practice

### Financial sustainability

**27.** As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on the Fund's financial sustainability. We define financial sustainability as having medium term (two to five years) and longer term (greater than five years) financial plans in place. We will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- the appropriateness and effectiveness of funding arrangements and the investment strategy in place to address any identified funding gaps
- whether the Fund can demonstrate the affordability and effectiveness of funding and investment decisions it has made.

### Financial management

**28.** Financial management in the context of a pension fund is complex and includes not just investment and funding strategy, but also arrangements for contract management, performance review, budget setting, forecasting and the financial control environment. We will review, conclude and report on:

- the Fund's financial performance and funding levels for the year, including performance against its investment strategy
- whether the Fund has arrangements in place to ensure systems of internal control are operating effectively
- whether the Fund can demonstrate the effectiveness of the budgetary control system
- whether the Fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

### Governance and transparency

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

pension fund sub-committee and pension board members is key to this process. We will review, conclude and report on:

- the governance disclosures in the annual report and accounts
- whether the Fund can demonstrate that the governance arrangements in place are appropriate and operating effectively
- whether there is effective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting
- the quality and timeliness of financial and performance reporting on the Fund's administration and investments
- consistency of the annual governance statement and the governance compliance statement with the disclosures made in the financial statements.

### Value for money

**30.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether the Fund can provide evidence that is demonstrating value for money in the use of resources, has focus on improvement and that there is a clear link to the outcomes delivered.

### Independence and objectivity

**31.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual "fit and proper" declaration for all members of staff. These arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**32.** The engagement lead (i.e. appointed auditor) for the Fund is Gillian Woolman, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of the Fund.

### Quality control

**33.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

**34.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice (and relevant supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews and internal quality reviews. The Institute of Chartered Accountants of Scotland (ICAS) have also been commissioned to carry out external quality reviews of our work.

**35.** As part of our commitment to quality and continuous improvement Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

# Orkney Islands Council Pension Fund

## Annual Audit Plan 2018/19

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