

Orkney Islands Council Pension Fund

2021/22 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Orkney Islands Council Pension Fund Sub-Committee and the
Controller of Audit

November 2022

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Key messages

2021/22 annual report and accounts

- 1 Our audit opinions on the annual report and accounts are unmodified.
- 2 The financial statements of Orkney Islands Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

Financial management

- 3 The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.
- 4 The Fund has returned an investment loss of 3% against a positive target of 9.6%.

Financial sustainability

- 5 Fund performance levels in 2021/22 were below target and the value of the fund fell, however, the Fund still has sufficient assets to cover its liabilities.
- 6 The Fund reviewed its investment strategy following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

Governance and transparency

- 7 Governance arrangements have been appropriate and operated effectively.
- 8 There is effective scrutiny, challenge and informed decision-making by committee.

Best Value

- 9 The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management costs.
- 10 Although the value of investments fell in 2021/22, the longer term increase in the value of net assets is the largest across Scottish pension funds.

Introduction

1. This report is a summary of our findings arising from the 2021/22 audit of Orkney Islands Council Pension Fund (the Fund).
2. The scope of our audit was set out in our Annual Audit Plan presented to the June 2022 meeting of the Pension Fund Sub-Committee. This report comprises:
 - an audit of the Fund's annual report and accounts
 - consideration of the wider dimensions of financial management, financial sustainability, governance and transparency, and value for money, that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. The main elements of our audit work in 2021/22 have been:
 - an audit of the Fund's 2021/22 annual report and accounts including the issue of an independent auditor's report setting out our opinions
 - a review of the Fund's main financial systems
 - consideration of the four audit dimensions of financial management, financial sustainability, governance and transparency and value for money.

Added Value

4. We add value to the Fund through the audit by:
 - identifying and providing insight on significant risks, and making clear and relevant recommendations
 - sharing intelligence and good practice through our national reports ([Appendix 2](#)) and good practice guides
 - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

Responsibilities and reporting

5. Orkney Islands Council is the administering authority for the Orkney Islands Council Pension Fund. The Council delegates this responsibility to the Pension Fund Sub-Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective.

The Pension Fund Sub-Committee is required to review the effectiveness of internal control arrangements and approve the annual report and accounts.

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

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

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

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

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

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

Auditor Independence

11. Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

12. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2021/22 audit fee of £22,090 as set out in our Annual Audit Plan remains unchanged.

13. This report is addressed to both the members of the Pension Fund Sub-Committee and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Audit appointment from 2022/23

14. The Accounts Commission is responsible for the appointment of external auditors to local government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The financial year 2021/22 was a one year extension and is the last year of the current appointment round

15. The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23 KPMG will be the appointed auditor for Orkney Islands Council Pension Fund. We are working closely with the new auditors to ensure a well-managed transition.

16. A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016. There are several significant changes introduced by the new Code, namely the integration of Best Value work into the wider scope audit work.

Acknowledgements

17. We would like to thank Orkney Islands Council Pension Fund Sub-Committee and Board members and other staff for their co-operation and assistance over the last six years.

1. Audit of 2021/22 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

Main judgements

Our audit opinions on the annual report and accounts are unmodified.

The financial statements of Orkney Islands Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

Our audit opinions on the annual report and accounts are unmodified

18. The annual report and accounts for the year ended 31 March 2022 were approved by the Orkney Islands Council Pension Fund Sub-Committee on 16 November 2022. We reported, within the independent auditor's report that:

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

The Covid-19 pandemic had minimal impact on our audit work

19. The unaudited annual report and accounts were received in line with our agreed audit timetable on 30 June 2022. As in the previous two years the audit was conducted remotely, observing social distancing measures.

20. The completeness and accuracy of accounting records and the extent of the information and explanations that were required for our audit were not affected by the Covid-19 outbreak.

21. 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 helped ensure that the audit of the annual accounts process ran smoothly.

There were no objections raised to the annual report and accounts

22. The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts.

23. Regulation 9 requires a local authority to give public notice on its website by 17 June of the right to inspect its annual report and accounts. The date for inspection should be 14 days after the publication of the notice but cannot be later than 1 July and the inspection should last for 15 working days from the date specified in the notice.

24. As part of our audit, we identified that the inspection notice was not published until 27 June 2022 and therefore was outwith the timescales required by the regulations.

25. No objections were raised in relation to the 2021/22 annual report and accounts.

Recommendation 1

Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014

Overall materiality was revised on receipt of the unaudited annual report and accounts to £5.1 million

26. We apply the concept of materiality in both planning and performing the audit. The determination of materiality is based on professional judgement and is informed by our understanding of the entity and what users are likely to be most concerned about in the annual accounts.

27. We identify a benchmark on which to base overall materiality, such as net assets, and apply what we judge to be the most appropriate percentage level for calculating materiality values. In assessing performance materiality, we have considered factors such as our findings from previous audits, any changes in business processes and the entity's control environment including fraud risks.

28. We use materiality to evaluate the effect of identified misstatements and uncorrected misstatements on the audit and financial statements and when forming the opinion in the auditor's report.

29. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

30. The revised materiality levels did not require a change in our audit approach as it did not change the assessment of material account areas.

Exhibit 1

Materiality values

Materiality level	Amount
Overall materiality	£5.1 million
Performance materiality	£3.8 million
Reporting threshold	£130 thousand
Specific materiality (applied to benefits expenditure and contributions income in the fund account)	£1 million
Specific performance materiality	£0.75 million

Source: Audit Scotland

Significant findings to report on the annual report and accounts

31. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have no issues to report from the audit.

32. We identified some disclosure and presentational matters which required amendment during our audit which have been reflected in the final set of accounts.

We have obtained audit assurances over the significant financial statements' risks as identified in our 2021/22 Annual Audit Plan

33. We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. [Exhibit 2](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan audit. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 2**Significant risks of material misstatement in the financial statements**

Audit risk	Assurance procedure	Results and conclusions
<p>1. Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<ul style="list-style-type: none"> • Assess the design and implementation of controls over journal entry processing. • Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments during the period. • Evaluate significant transactions outside the normal course of business. • Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements. • Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. • Substantively test income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Undertake focussed testing of accounting accruals and prepayments. 	<p>We have not identified any indication of management override in the year leading to material misstatement or significant concern.</p> <p>We have reviewed the board's accounting records and obtained assurance that there were no transactions outside normal business processes.</p> <p>We have also reviewed management estimates and the journal entries posted in the period and around the year end. We did not identify any areas of bias in key judgements made by management.</p>

Other areas of audit focus

34. We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks.

35. We kept these areas under review throughout our audit based on the findings of the audit procedures performed. The results of our audit procedures and conclusions are set out in [Exhibit 3](#).

Exhibit 3

Other areas of audit focus

Audit risk	Results and conclusions
<p>Actuarial valuation of future retirement benefits</p> <p>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. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary and review actuarial assumptions, and consider the report by Audit Scotland's consulting actuary on the actuarial valuations</p>	<p>We are satisfied that the retirement benefit obligation is correctly disclosed in the notes to the accounts in line with International Accounting Standard (IAS) 26 Accounting and Reporting by Retirement Benefit Plans.</p> <p>We use an auditor's expert to inform our review of the assumptions used in calculating this estimate and management's judgements. We concluded the assumptions are appropriate and within a range which we consider to be acceptable with assumptions towards the middle of the benchmarked range.</p>
<p>Valuation of unquoted investments</p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, and confirm valuations to valuation reports and/ or other supporting documentation for significant unquoted investments.</p>	<p>We gained appropriate assurance over the competency, capability and objectivity of fund managers.</p> <p>Each year, the pension fund receives internal control reports on their investment managers, and the custodian. These are high-level reports 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.</p> <p>The controls in place at fund managers are a key source of assurance over the investment values provided to the Fund and recorded in the annual report and accounts. In line with good practice the finding from the internal control reports should be presented to the Pension Fund Sub-Committee as part of the governance assurance framework.</p> <p>Recommendation 2</p> <p>(Refer Appendix 1, action plan)</p> <p>The valuations were agreed to valuation reports provided by the custodian and the fund managers. The custodian holds the Fund's securities for</p>

Audit risk	Results and conclusions
	<p>safekeeping in order to minimise the risk of their misappropriation, misuse, theft and loss.</p> <p>The custodian only covers investments held by one of four fund managers. Three of the fund managers have been appointed over the last three financial years as a result of the change in the investment strategy. The Fund should consider expanding the use of the custodian to cover all fund managers in line with best practice.</p> <p>Recommendation 3</p> <p>(Refer Appendix 1, action plan)</p>

Identified misstatements of £10 million were adjusted in the accounts

36. Total misstatements identified were £10 million in relation to the understatement of purchases and sales of investments in year. The adjustment did not impact the net loss on investments or the net assets held by the fund at the year-end. Note 13 to the accounts outlines the in-year transactions and was adjusted to reflect the increased level of purchases and sales which took place in 2021/22.

37. We have reviewed the nature and causes of these misstatements and have concluded that they arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error.

38. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. Management have adjusted all identified misstatements above our reporting threshold and there are no unadjusted errors to report.

2. Financial management

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

Main judgements

Fund performance levels in 2021/22 were below target and the value of the fund fell, however, the Fund still has sufficient assets to cover its liabilities.

The Fund reviewed its investment strategy following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

The annual performance of the Fund was significantly impacted by Covid-19 and other world events

39. When considering the investment performance of the Fund during 2021/22, it is important to recognise the impact of Covid-19 and other world events on financial markets and investments. The global impact of the pandemic and the conflict in Ukraine has significantly increased market volatility. The Fund's performance in 2021/22 is summarised in [Exhibit 5](#).

40. The Fund has faced a challenging year in 2021/22. The net assets of the Fund, decreased from £520.8 million at 31 March 2021 to £508.5 million at 31 March 2022, after reaching a peak of £561.3 million in December 2021, the invasion of Ukraine cited as of significant impact. Consequently the Fund had a negative performance of 3%, against a benchmark of 9.6%.

41. Over recent years the fund has diversified investments, however, over 80% of the Fund's investments remain within growth assets which are generally more volatile.

Exhibit 5

Assets, funding level and investment performance

Decrease in net assets	Funding level	Estimated Past Service Liabilities	Investment performance
£508.5 million	137%	£375 million	-3.0%
Closing net assets as at 31 March 2022 (-2.36%)	Net assets vs promised retirement benefits 31 March 2022	Closing liabilities as at 31 March 2022 (4%)	Return on investments 2021/22
£520.8 million	146%	£355 million	8.2%
Opening net assets at 1 April 2021	Net assets vs promised retirement benefits 31 March 2021	Opening liabilities as at 1 April 2021	Average annual return on investments over 5 years

Source: 2021/22 Orkney Islands Council Pension Fund unaudited annual report and accounts

42. Hymans Robertson estimated the pension liabilities increased by 4% to £375 million at 31 March 2022 (2020/21 – £355 million). This estimate uses assumptions in line with International Accounting Standard (IAS) 26 requirements, for the purposes of the Fund’s financial statements.

43. The funding level takes into consideration the level of assets held by the Fund and the liability estimated at the year-end. The reduction in asset value combined with the increase in estimated liabilities has resulted in a 9 per cent drop in the funding level from 146 per cent to 137 per cent over 2021/22.

The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance

44. The financial regulations of the Council, as administering authority, apply to the Fund. We consider these to be comprehensive, and current, and promote good financial management.

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

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

Financial systems of internal control operated effectively

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

48. Our work in 2021/22 covered the key controls over the systems used for pension administration activity and the pension fund's investments. The Fund also uses the financial systems of the administering authority, Orkney Islands Council. The main council systems used by the Fund are the general ledger system and the payroll system. Our review of the controls in operation within these systems was conducted as part of our audit of Orkney Islands Council.

49. Our review of the systems used by the Fund and the administering authority did not identify any significant control weaknesses which could affect the Fund's ability to report financial and other relevant data in the financial statements, and we concluded that systems of internal control for the Fund operated effectively during 2021/22.

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

50. The Fund is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption. Furthermore, it is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

51. The risk profile of public bodies during 2021/22 has been significantly affected by the Covid-19 pandemic. This is likely to have increased the risk of fraud and error as control environments and internal controls have had to change to allow for services to operate effectively and respond to issues in a timely manner.

52. The Fund relies on the Council's arrangements for the prevention and detection of fraud and corruption. We have reviewed the arrangements put in place by the Council to address any heightened risks and concluded that there are appropriate arrangements for the prevention and detection of fraud, error and irregularities.

3. Financial sustainability

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

Main judgements

Although the value of the fund fell in 2021/22, the Fund still has sufficient assets to cover its liabilities

The Fund reviewed its investment strategy following the triennial valuation and will continue to diversify the investment structure to support income generation.

We have no concerns over the financial sustainability of the fund or the viability of its funding strategy

53. The results of the 2020 full triennial valuation of the Orkney Islands Council Pension Fund showed a funding level of 118%, an improvement over the 2017 level of 112.7%. This meant that, overall, the Fund had a surplus of assets over liabilities and that the fund assets were sufficient to meet 118% of its liabilities.

54. The Fund obtains an interim valuation from the actuary which uses the same base as the triennial funding valuation, rolled forward to take account of changes in membership and updated assumptions.

55. The Fund has faced a challenging year in 2021/22 in terms of investment performance, with a significant fall in value of investments in the final quarter. The funding level decreased by 9% from 146% in 2021/22, however, the significant rise in the value of the fund in 2020/21 means that the fund has still increased since the triennial valuation.

Medium term financial planning arrangements are appropriate and effective

56. There is considerable volatility in pension funding and the results of the triennial valuation are in effect a snapshot of the Fund at 31 March 2020. Following each triennial valuation, the Fund reviews and revises its funding strategy. The funding strategy is a summary of the Fund's approach to funding liabilities. The investment strategy outlines the types of investment to be held and the balances between the different types of investment.

57. The last review was carried out in 2021 after the results of the triennial valuation. The revised investment strategy reflects the Fund's decision to focus on income generation to build capacity to fund annual benefits

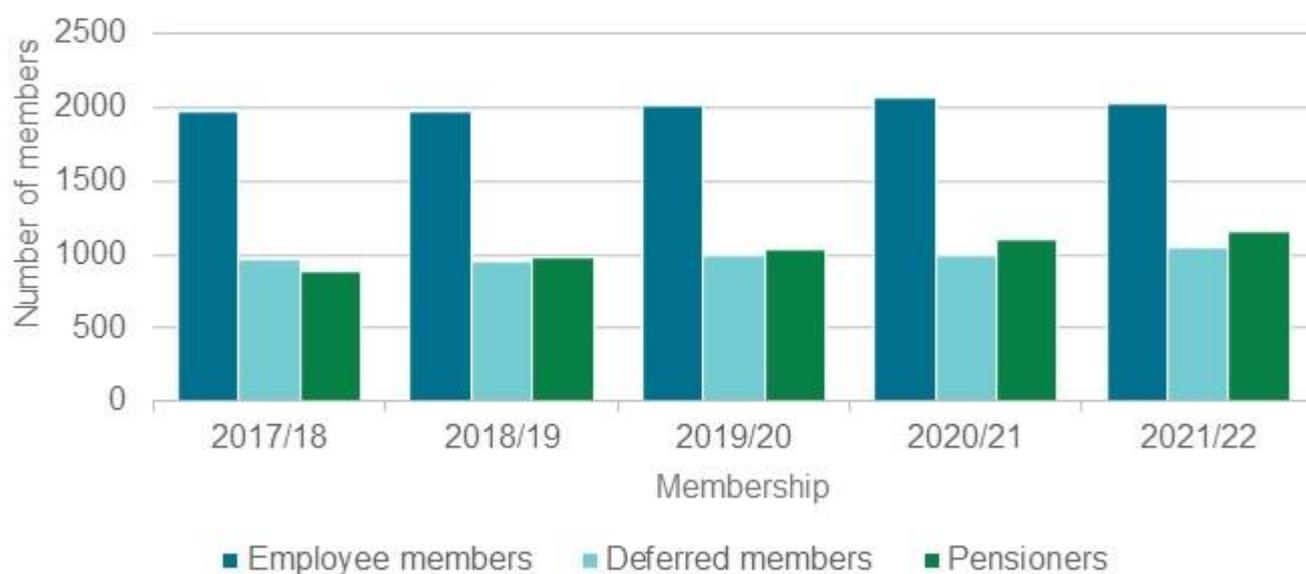
should they move to a net withdrawals position. The investment strategy therefore reflects a continued divestment in equities.

Fund membership levels continue to increase but the ratio of active members to pensioners is reducing

58. The Fund is a multi-employer fund with four admitted bodies in addition to members employed by Orkney Islands Council. The current membership profile is shown at [Exhibit 6](#). The number of active members continues to outweigh the number of pensioners.

59. The Fund gives its members a guarantee that in exchange for contributions during their employment, it will pay a pension until the end of each member's life. It is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

Exhibit 6 Orkney Islands Council Pension Fund Membership



Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

60. Membership of the fund increased by 172 to 4,339 members at 31 March 2022; an increase in membership of 4%. The impact of auto-enrolment continues to contribute to the increase in employee members.

61. In 2021/22 the number of pensioners receiving a pension from Orkney Islands Council Pension Fund increased by 58 and the number of pensioner members continues to increase steadily each year. The number of active members continues to outweigh the number of pensioners but the ratio of active members to pensioners has reduced over the past five years.

Future rates of employer contributions have remained stable

62. Following the triennial valuation in 2020, the actuary agreed employer contribution rates with individual employers from 1 April 2021 until 31 March 2024. For all member bodies the employer rate has remained at 17%. The approximate split of all contributions received in year is set out at [Exhibit 7](#).

Exhibit 7 Contributions in 2021/22

	Orkney Islands Council £m	Admitted bodies £m	Total £m
Employer contributions	7.22	0.85	8.07
Employee contributions	2.59	0.33	2.92
Strain contributions	0.11	0	0.11

Source: Orkney Islands Council Fund 2021/22 unaudited financial statements

63. Cash flows received from dealings with members continue to be positive as the contributions received in year exceed the amount paid out in benefits

64. The majority of Scottish Local Government Pension Schemes pay out more in pension benefits than they receive in pension contributions. The Fund is not yet in this position. This demonstrates a relatively good position in terms of financial sustainability as the Fund is not reliant on investment income to support annual payments to pensioners.

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

4. Governance and transparency

The effectiveness of scrutiny and oversight and the transparent reporting of information

Main judgements

Governance arrangements have been appropriate and operated effectively.

There is effective scrutiny, challenge and informed decision-making by committee.

Governance arrangements are appropriate and operate effectively

66. The Pension Fund Sub-Committee has been delegated responsibility for governance of the Fund by Orkney Islands Council, the administering authority.

67. The Pension Fund Sub-Committee is supported by a Pension Board in compliance with regulations and the requirements of the Pensions Regulator.

68. Following the local government elections in May 2022 a new Sub-Committee was appointed. This included 3 councillors who served on the Sub-Committee during 2021/22 and 4 councillors who were newly appointed to the sub-committee. The Pension Board also appointed 2 new members.

69. Due to the specialised nature of the Fund, it is vital that members have appropriate knowledge and understanding to provide appropriate challenge and scrutiny. Members are required to carry out appropriate levels of training to ensure they can perform their required duties.

70. A formal induction programme was delivered in June 2022 for all new members of the Council and included a presentation from the actuary covering the investment strategy and fund managers.

71. The Fund prepares an annual training plan which covers training, including The Pensions Regulator Trustee Toolkit training, and other essential training that will assist members in discharging their fiduciary duty.

There are effective arrangements for complying with The Pensions Regulator Public Service Code

72. The Public Sector Pensions Act 2013 provided for extended regulatory oversight by The Pensions Regulator. The Pensions Regulator issued a code

on the governance and administration of public service pension schemes in January 2015 which funds are expected to comply with.

73. The Fund conducts a compliance review against the code on a regular basis and reports annually as part of the Annual Accounts through the Governance Compliance Statement. This provides assurance that the Fund is in compliance with the regulations.

74. There were no breaches of the code that required to be reported to The Pensions Regulator in 2021/22. In 2019/20 we identified that the Fund did not maintain a breaches register which heightens the risk that systematic issues are not identified by management. We are pleased that this was implemented during 2021/22 ([Appendix 1](#)).

Performance reporting was of a good standard

75. Management Commentaries included in the annual accounts should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

76. The Fund's 2021/22 management commentary is of good quality and is written with the stakeholder in mind. It presents some complex areas in an understandable style which increases transparency in reporting the financial performance and financial position.

5. Best Value

Using resources effectively and continually improving services

Main judgements

The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management costs.

Although the value of investments fell in 2021/22, the longer term increase in the value of net assets is the largest across Scottish pension funds.

The pension administration function has performed well against targets

77. The Pension Fund Sub-Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance. The focus of measuring the performance of pensions administration includes both member experience and statutory compliance. Performance of the administration of the fund is summarised in [Exhibit 8](#) below.

78. Service levels were maintained in the majority of areas; however, they did fall in processing refunds and pension estimates as a result of additional pressure on staff due to Covid-19. It should be noted that the relatively small size of the fund and transactions involved mean that even small numbers of records not being processed can make significant percentage differences.

Exhibit 8

Administration Performance

	Performance Standard (days)	Percentage processed within standard 2020/21	Percentage processed within standard 2021/22	Relative performance compared to prior year
Pension estimates	10	92.8%	96.8%	↑
Retirements	5	100.0%	100.0%	→
Transfers in	10	100.0%	94.4%	↓

Transfers Out	10	100.0%	100.0%	➔
Refunds	5	94.1%	84.6%	⬇
New Entrant Information	10	100%	100%	➔
Leaver Information	10	100%	100%	➔
Deferred Benefit Information	1 Month	95.4%	100%	⬆

Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

The continuing impact of Covid-19 and the conflict in Ukraine on global markets reduced annual returns

79. The Fund appoints four external investment managers. Individual investment manager performance is reviewed regularly by the Pension Fund Sub-Committee.

80. [Exhibit 9](#) shows that the Fund generated a return of -3% against a benchmark of 9.6%.

Exhibit 9 Fund investment performance



Source: Orkney Islands Council Pension Fund 2021/22 unaudited financial statements

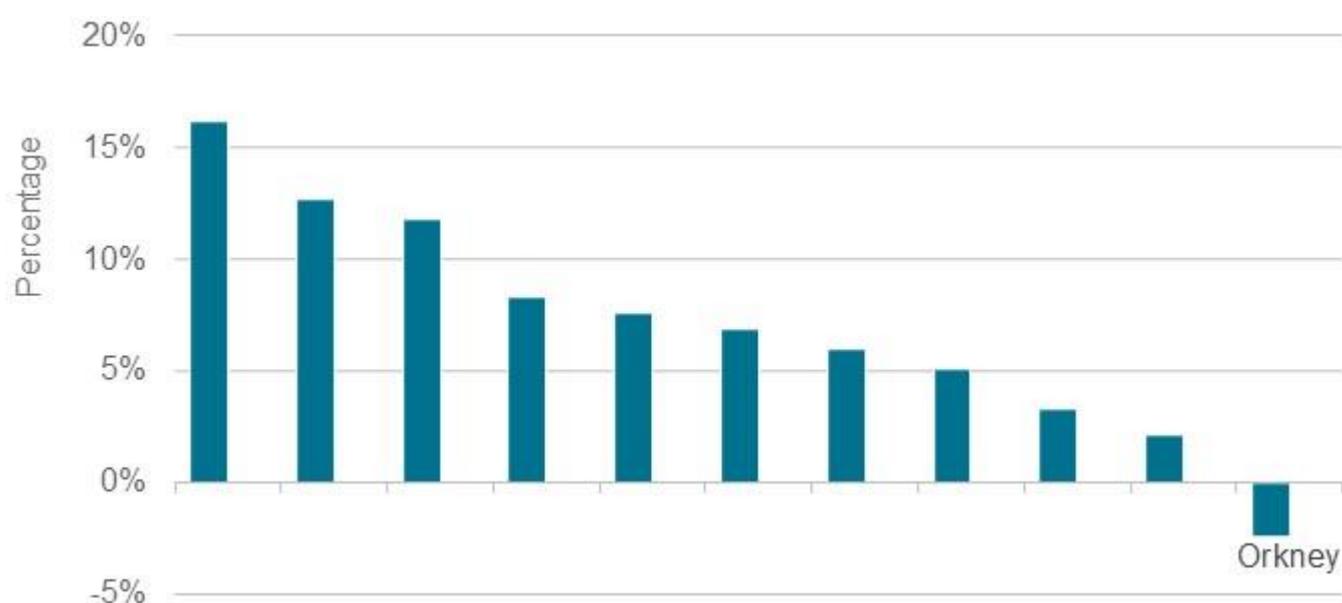
81. Financial markets have been exceptionally volatile in recent years due to the ongoing Covid-19 pandemic and more recently as result of the conflict in

Ukraine. Returns against most asset classes, especially equities reduced significantly in the final quarter of 2021/22. Approximately 60% of the Fund's investment portfolio is made up of equities and this is a significant contributor to the decrease.

82. The negative investment return is the lowest across Scotland, as can be seen in [Exhibit 10](#) below, however, when reviewing the Fund's performance, it is important to consider the longer term. The Fund was marginally behind the three and five year benchmarks with the weaker performance in the current year being offset by strong performance in previous years.

Exhibit 10

Fund investment performance across Scotland 2021/22



Source: Unaudited annual accounts for Scottish pension funds 2021/22

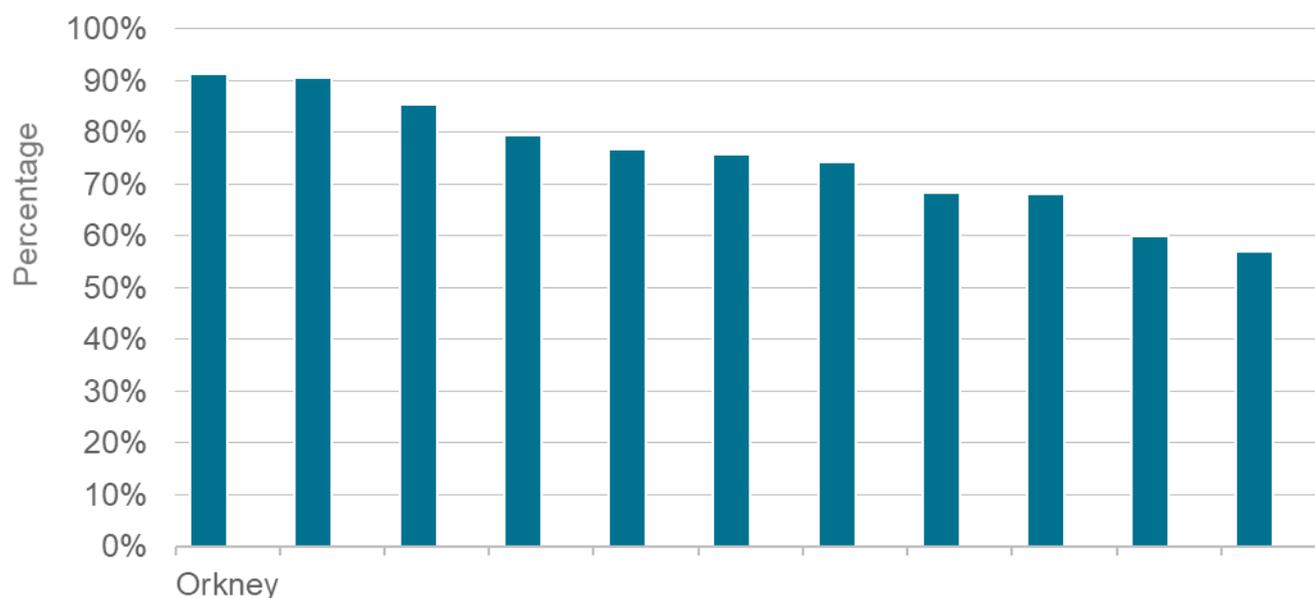
83. The Fund has over 80% of funds invested in growth assets which were impacted adversely by the market volatility in 2021/22. We have considered the longer term trends in [Exhibit 11](#) which shows the change in the value of funds since April 2016.

84. The change in value includes the return on investments, the impact of transfers in and out the fund and the net contributions from dealings with members.

85. Over the six year period the value of Orkney has the largest increase in value across Scotland.

Exhibit 11

Change in value of funds since 1 April 2016



Source: Unaudited annual accounts for Scottish pension funds 2021/22

The Fund scrutinises investment management expenses appropriately

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

87. Investment management expenses have increased from £1.905 million in 2020/21 to £2.231 million in 2021/22. Investment manager expenses can vary due to a number of factors including actual return on investments and the nature of investments held. Although overall asset values dropped in year, until December 2021 there was strong asset performance which would have resulted in high management fees.

88. The Fund has also diversified its portfolio and employs an additional fund manager which will have increased costs.

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

National performance audit reports

90. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2021/22, we published reports which may be of interest to the Fund. These are outlined in [Appendix 2](#) accompanying this report.

Appendix 1

Action plan 2021/22

2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Advertising the Financial Statements</p> <p>The financial statements were not advertised in accordance with the Local Authority Accounts (Scotland) Regulations 2014.</p> <p>Risk – there is a risk that the public does not have the ability to inspect and object to the accounts as appropriate.</p>	<p>Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014</p> <p>Paragraph 24.</p>	<p>Agreed, we have updated our accounts closure timetable to include this date and ensure it is met going forward.</p> <p>Service Manager (Corporate Finance)</p> <p>Completed</p>
<p>2. ISAE3402 Control Reports</p> <p>Each year, the pension fund receives internal control reports on their investment managers and the custodian. 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.</p> <p>Risk – there is a risk that members are not aware of issues identified at the fund managers.</p>	<p>To enhance performance management reporting, details of the investment manager internal control reports should be provided to members of the pension fund sub-committee along with any observations raised by management.</p> <p>Paragraph 35.</p>	<p>Agreed, details of investment manager internal control reports will be provided to members of the pension fund sub-committee along with any observations raised by management going forward.</p> <p>Senior Manager (Corporate Finance)</p> <p>November 2022</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>3. The Custodian</p> <p>The custodian covers investments held by only one of four fund managers. The custodian holds the Fund's securities for safekeeping in order to minimise the risk of their misappropriation, misuse, theft and loss.</p> <p>Risk – there is an increasing proportion of the Fund's assets which are not covered by custodian safeguards.</p>	<p>Consideration should be given to expanding the use of the custodian to cover all fund managers.</p> <p>Paragraph 35.</p>	<p>Agreed, a review of existing operations will include expanding the role of custodian.</p> <p>Senior Manager (Corporate Finance)</p> <p>March 2023</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>4. Breaches register</p> <p>There is no register held by the Fund detailing the breaches of the Pensions Regulator Public Service Code in year.</p> <p>Risk</p> <p>There is a risk that an issue is not raised with management which requires to be reported</p>	<p>We recommend the Fund creates a register of all breaches to inform the decision over whether to report issues to the Pensions Regulator.</p>	<p>Complete</p> <p>The Register of Breaches has been created by the Pension and Payroll Manager.</p>
<p>5. Validation of fund manager valuations</p> <p>Barings provided a valuation of investments held at 31 March 2020. From our review of the document it was not possible to identify the Fund's share of assets. No work has been conducted by the Fund to validate the valuation provided by Barings.</p> <p>Risk</p>	<p>We recommend the Fund conducts work to assure themselves that asset valuations provided by the fund manager are reasonable and in line with expectation.</p>	<p>Complete</p> <p>We are satisfied that the Fund Manager uses an external valuer to provide additional advice over hard to value assets. We are aware that the Fund also takes assurance from the ISAE3402 reports from fund managers which covers the controls over the valuation process and we have made recommendations above to</p>

Issue/risk	Recommendation	Agreed management action/timing
There is a risk that a misstatement in the valuation is not noticed by the Fund on a timely basis.		improve the governance around this process.

Appendix 2

Summary of national performance reports 2021/22 and briefing papers

May

[Local government in Scotland Overview 2021](#)

June

[Covid 19: Personal protective equipment](#)

July

[Community justice: Sustainable alternatives to custody](#)

September

[Covid 19: Vaccination programme](#)

January

[Planning for skills](#)

[Social care briefing](#)

February

[NHS in Scotland 2021](#)

March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

Orkney Islands Council Pension Fund

2021/22 Annual Audit Report

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