



**Item: 4**

**Pension Fund Sub-committee: 21 May 2025.**

**Orkney Islands Council Pension Fund – External Audit Plan.**

**Report by Head of Finance.**

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## **1. Overview**

- 1.1. Regulation 55 of the Local Government Pension Scheme (Scotland) Regulations 2018 states that councils responsible for administering a pension fund (administering authorities) are required to publish a Pension Fund Annual Report containing the financial statements of the Pension Fund.
- 1.2. Audit Scotland appointed KPMG as external auditor of the Council's Pension Fund for the five-year period from 2022 to 2027. Financial year 2024/25 is the third year of this appointment.
- 1.3. KPMG's responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice and are guided by the auditing profession's ethical guidance.
- 1.4. Following the conclusion of each year's planning process, the external auditor prepares an annual plan detailing the work to be undertaken as part of the annual audit of the Council's Pension Fund. The plan sets out the ways in which KPMG will meet its respective responsibilities under the Code of Audit Practice.
- 1.5. The external audit plan for 2024/25 in respect of the Council's Pension Fund, prepared by KPMG, is attached as Appendix 1 to this report.

## **2. Recommendations**

- 2.1. It is recommended that members of the Sub-committee:
  - i. Note the external audit plan for 2024/25 in respect of the Council's Pension Fund, prepared by KPMG, attached as Appendix 1 to this report.

### 3. Audit Plan 2024/25

- 3.1. The Annual Audit Plan 2024/25, attached as Appendix 1 to this report, contains an overview of the planned scope and timing of the Pension Fund audit. The plan identifies the work required to provide an opinion on the financial statements and related matters and to meet the wider scope requirements of the public sector audit. The wider scope of public audit contributes to conclusions on the financial management, financial sustainability, vision, leadership and governance and use of resources to improve outcomes.
- 3.2. KPMG's risk assessment draws on their knowledge of the Fund, its major transaction streams, key systems of internal control and risk management processes, as well as discussions with staff. The following presumed significant risks have been recognised in the audit plan:
- Management override of controls:
    - Professional standards require KPMG to communicate 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.
  - Other areas of audit focus:
    - Valuation of investments (Levels 1, 2 and 3).
    - Recording of investments (Levels 1, 2 and 3).
- 3.3. KPMG will provide an independent auditor's report to members of the Council, as the administering authority for the Pension Fund, the Accounts Commission for Scotland and Audit Scotland, setting out its opinions on the annual accounts, and will provide the Pension Fund Sub-committee, the Accounts Commission and Audit Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.
- 3.4. The timetable for completion of the audit cycle is to present the annual audit report to the Pension Fund Sub-committee on 24 September 2025, with the annual accounts signed on or before the 30 September 2025 deadline.

**For Further Information please contact:**

Erik Knight, Head of Finance, extension 2127, Email [erik.knight@orkney.gov.uk](mailto:erik.knight@orkney.gov.uk)

## Implications of Report

### 1. **Financial:**

- Audit Scotland charges a set fee for KPMG undertaking the audit of the Council's Pension Fund. In determining the audit fee, external auditors have taken account of the risk exposure of the Fund, the planned management assurances in place and the level of reliance they plan to take from the work of internal audit. The audit approach assumes receipt of the unaudited annual accounts, with a complete working papers package by 30 June 2025.
- Audit Scotland's fee proposal for the Pension Fund Audit 2024/25 is £26,800 a rise of 1.7% in comparison to the fee of £26,350 for 2023/24. The annual audit fee is paid for from the Pension Fund budget.

2. **Legal:** An external audit and review of the Council's Pension Fund helps the Council to meet its statutory obligation to secure best value.

3. **Corporate Governance:** The Pension Fund Sub-committee has responsibility to discharge all functions and responsibilities relating to the Council's role as administering authority for the Orkney Islands Council Pension Fund, as defined in the Scheme of Administration.

4. **Human Resources:** Not applicable.

5. **Equalities:** An Equality Impact Assessment is not required.

6. **Island Communities Impact:** An Island Communities Impact Assessment is not required.

7. **Links to Council Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Council Plan strategic priorities:

- Growing our economy.
- Strengthening our communities.
- Developing our Infrastructure.
- Transforming our Council.

8. **Links to Local Outcomes Improvement Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Local Outcomes Improvement Plan priorities:

- Cost of Living.
- Sustainable Development.
- Local Equality.
- Improving Population Health.

9. **Environmental and Climate Risk:** Not applicable

10. **Risk:** The industry and wider economic environment that the Pension Fund operates in has high levels of risk and therefore it is a requirement for an annual audit to be carried out by an independent auditor appointed to the Council by Audit Scotland.

11. **Procurement:** Not applicable.
12. **Health and Safety:** Not applicable.
13. **Property and Assets:** Not applicable.
14. **Information Technology:** Not applicable.
15. **Cost of Living:** Not applicable.

**List of Background Papers:**

None

**Appendix**

Appendix 1 - Orkney Islands Council Pension Fund – External Audit Plan for the year ended 31 March 2025



# Orkney Islands Council Pension Fund

Report to the Pension Sub-Committee of  
Orkney Islands Council Pension Fund

**Audit plan and strategy for the  
year ended 31 March 2025**

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29 April 2025

# Introduction

## To the Pension Sub-committee of Orkney Islands Council Pension Fund

We are pleased to have the opportunity to meet with you to discuss our audit of the financial statements of Orkney Islands Council Pension Fund (the 'Fund'), as at and for the year ended 31 March 2025.

This report outlines our risk assessment and planned audit approach. Our planning activities are still ongoing, and we will communicate any significant changes to the planned audit approach subsequently. We provide this report to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

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## The engagement team

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

Other key members of the engagement team include Kunal Malhotra as engagement manager. He has more than 8 years of industry experience. Kunal will be responsible for overseeing the delivery of our audit.

Yours sincerely,

**Julie Radcliffe**

Julie Radcliffe

Engagement Director

29 April 2025

## 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. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

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.

We depend on well planned timing of our audit work to avoid compromising the quality of the audit. This is also heavily dependent on receiving information from management and those charged with governance in a timely manner. The audit undertaken in the current year is dependent on the finalisation of the previous auditor's work over historical financial statements.

### Restrictions on distribution

This report is intended solely for the information of those charged with governance of **Orkney Islands Council Pension Fund** and the report is provided on the basis that it should not be distributed to other parties; that it will not be quoted or referred to, in whole or in part, without our prior written consent; and that we accept no responsibility to any third party in relation to it.



# Overview of planned scope including materiality

## Our materiality levels

We determined materiality for the Orkney Islands Council Pension Fund financial statements at a level which could reasonably be expected to influence the economic decisions of users taken based on the financial statements. We used a benchmark of the Fund's total assets which we consider to be appropriate given the sector in which the Fund operates, its ownership and financing structure, and the focus of users.

We considered qualitative factors such as business environment, other sensitivities such as changes in regulation when determining materiality for the financial statements as a whole.

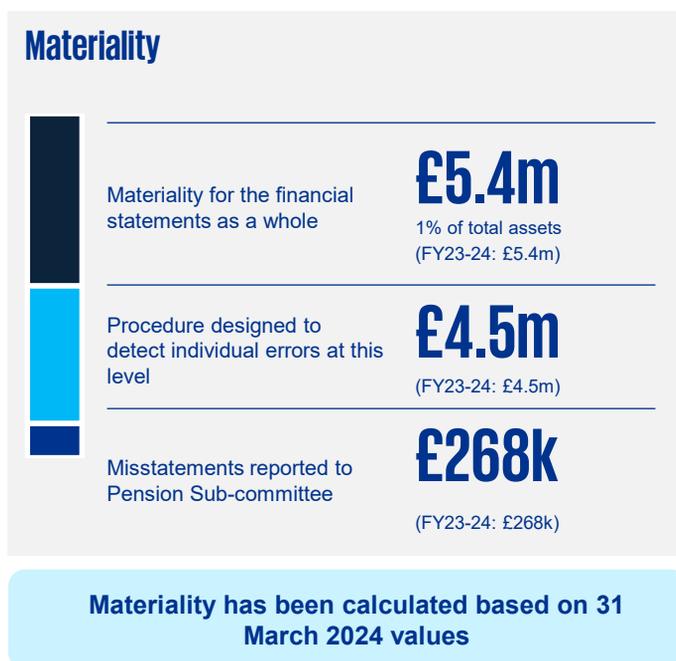
To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of materiality [£4.5m / 75% of materiality] driven by our expectations of low level of undetected or uncorrected misstatements in the period.

We will report misstatements to the Pension Sub-committee including:

- Corrected and uncorrected audit misstatements above £268k.
- Errors and omissions in disclosure (Corrected and uncorrected) and the effect that they, individually and in aggregate, may have on our opinion.
- Other misstatements we include due to the nature of the item.

## Control environment

The impact of the control environment on our audit is reflected in our planned audit procedures.



# Overview of planned scope including materiality (cont.)

## Timing of our audit and communications

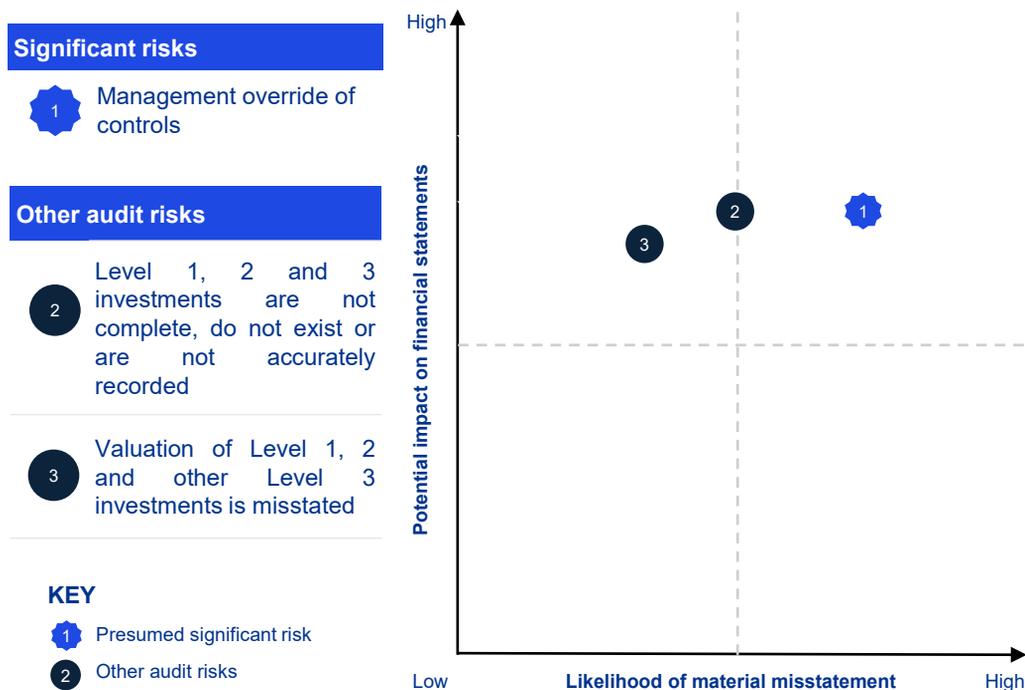
- We will maintain communication led by the engagement partner and manager throughout the audit. We set out below the form, timing and general content of our planned communications:
- Kick-off meeting with management where we present our draft audit plan outlining our audit approach and discuss management's progress in key areas
- Pension Sub-committee meeting on 21 May 2025 where we present our final audit plan
- Regular status meetings with management where we communicate progress on the audit plan, any misstatements, control deficiencies and significant issues
- Closing meeting with management in end of August or early September 2025 here we discuss the auditor's report and any outstanding deliverables
- Pension Sub-committee meeting on 24 September 2025 where we communicate audit misstatements and significant control deficiencies

# Significant risks and other audit risks

Our risk assessment draws upon our understanding of the applicable financial reporting framework, knowledge of the pension fund, the industry and the wider economic environment in which Fund operates.

We also use our regular meetings with senior management to update our understanding and take input from component audit teams and internal audit reports.

Due to the current levels of economic uncertainty there is an increased likelihood of significant risks emerging throughout the audit cycle that are not identified (or in existence) at the time we planned our audit. Where such items are identified we will amend our audit approach accordingly and communicate this to the Pension Sub-committee.



## Wider Scope risk assessment

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

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 10 – 15.

# Audit risks and our audit approach

## 1 Management override of controls(a)

Fraud risk related to unpredictable way management override of controls may occur



### Significant audit 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.

*Note: (a) Significant risk that professional standards require us to assess in all cases.*



### 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.
- We will assess accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.
- We will 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 and post-closing adjustments. We will evaluate the design and implementation of automated controls used in the financial reporting process, where automated controls are in place.
- Assess the business rationale and the appropriateness of the accounting for significant transactions that are outside the normal course of business or are otherwise unusual.
- With regards to the financial reporting and journals process, we will perform the following over journal entries and other adjustments:
  - Evaluate the completeness of the population of journal entries.
  - We will determine high risk criteria and select journals based on this criteria for testing.

# Audit risks and our audit approach (cont.)

2

## Level 1, 2 and 3 investments are not complete, do not exist or are not accurately recorded



### Significant audit risk

- Level 1, 2 and 3 investments are not complete, do not exist or are not accurately recorded.
- Investments are held to pay benefits of the Fund. They are held with 4 investment managers across the number of asset classes. The investments are material to the financial statements (99% of the Statement of Net Assets) and therefore there is a risk of material misstatement.



### Planned response

- As part of our audit procedures, we will gain an understanding of the processes over the completeness, existence and accuracy of Level 1, 2 and 3 investments. This will include gaining an understanding of the control environment at all the investment managers and custodian (BNYM) by reviewing their internal controls reports to identify any control deficiencies that would impact our audit approach (where available).
- We will obtain direct confirmations from your custodian and all your investment managers to vouch the holdings and valuation of assets at the year end.
- We will vouch purchases and sales to investment manager and custodian reports (where available).
- We will recalculate change in market value and compare this to the overall investment return stated in the Pension Sub-committee's report for consistency with the amounts reported in the financial statements. We will investigate any material deviations.

# Audit risks and our audit approach (cont.)

3

## Valuation of Level 1, 2 and other Level 3 investments is misstated



### Significant audit risk

- Investments are held to pay benefits of the Fund. They are largely held as pooled investment vehicles with around 4 investment managers across a number of asset classes. The investments are material to the financial statements (99% of the Statement of Net Assets) and therefore there is a risk of material misstatement.
- There is a risk of material misstatement relating to fair values of level 1 and 2 pooled investments, due to the estimation uncertainty resulting from the pricing of these investments.
- There is an elevated risk of material misstatement relating to fair values of level 3 pooled investments, due to the estimation uncertainty resulting from unobservable inputs to these investments.



### Planned response

- **Segregated financial instruments:** Our in-house investment team, iRADAR, will be continue to be engaged to independently re-value the segregated securities and identify stale price issues of directly held financial instruments within the investment portfolio as well as any exposures to hard to value assets.
- **Pooled Investment Vehicles (Level 1 and 2):** We will re-calculate the value of level 1 and 2 pooled investment vehicles using published pricing at the year (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.
- **Pooled Investment Vehicles (Level 3):** For each Level 3 investment manager, we will obtain the unaudited Net Asset Value ('NAV') Statement at (or closest to) the measurement date and vouch the valuation to this. For a sample of level 3 pooled investments vehicles, we will further assess the reliability of the NAV statement by:
  - Obtaining and inspecting the latest audited financial statements for the underlying funds where available;
  - Inspecting the audit report to confirm that it is unqualified and that the audit has been carried out by a reputable audit firm; and
  - Comparing the unaudited pricing information at the year end to the audited financial statements valuation. Where the audited financial statements are not as at the Fund year end date, we will agree them to unaudited pricing information at that date and reconcile significant movements to the Fund year end date agreeing movements to quarterly NAV/transaction statements.

# Audit risks and our audit approach (cont.)

## Revenue – rebuttal of significant risk

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

Revenue in a pension fund equates to contributions receivable. This revenue is recognized based on specific instructions as set out in the appropriate schedule(s). There are no subjective issues concerning when contributions need to be recognized. Amounts involved cannot easily be manipulated through accounting policies, issue of credit notes, timing or other policies. There is little incentive for the Fund management 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 fund audits.

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# Wider Scope

# Wider Scope arrangements

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 Code of Audit Practice has set out four areas that constitute the wider scope of public audit in Scotland as below:

- Financial Management – Page 12;
- Financial Sustainability – Page 13;
- Vision, Leadership and Governance – Page 14; and
- Use of Resources to Improve Outcomes – Page 15

We set out below an overview of our approach to wider scope requirements of our annual audit.

## Local Risk Assessment

We are required to consider the arrangements in place for the wider-scope areas when undertaking annual risk assessment with a view to preparing the Annual Audit Plan.

As part of our risk assessment, we have considered the arrangements in place for the wider-scope areas and have summarised the results of our assessment and our planned response on the following pages.

## National Risk Assessment

Guidance may supplement auditors' own local risk assessments where there are particular areas of national or sectoral risk that the Auditor General and Accounts Commission wish auditors to consider. However, there are no such risks specified for 2024/25.

# Wider Scope arrangements

## Financial Management

### Scope

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

### 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

### Risk Assessment

As part of previous year audit, we noted that:

- The framework of governance, risk management and control were found to be comprehensive and effective.
- Fund has appropriate and effective financial management arrangements in place.
- A budget monitoring system is in place.
- The Fund relies on the Council's arrangements for the prevention and detection of fraud and corruption.
- The pension benefits policy oversight and day-to-day administration for the Fund is administered by the Pensions Team within the Enterprise & Sustainable Regeneration Service.

Based on above we have not identified any significant risks in relation to financial management.

### Planned Audit Response

We will continue to review the financial management arrangements in place.

# Wider Scope arrangements

## Financial sustainability

### 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.

### 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?

### Risk Assessment

As part of our previous year audit we noted that the Council has a number of arrangement in place, in relation to financial sustainability, including a medium-term financial strategy, monitoring performance against the plan and reserves strategy.

Based on above we have not identified any significant risks in relation to financial sustainability.

### Planned Audit Response

We will continue to review the financial sustainability arrangements in place.

# Wider Scope arrangements

## Vision, Leadership and Governance

### 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.

### 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.

### Risk Assessment

As part of our previous year audit, we noted that:

- Pension Fund has effective strategic planning in place
- Governance arrangements are appropriate and operated effectively.
- Arrangements are in place in relation to security, challenge and transparency

Based on above we have not identified any significant risk in relation to the Fund's arrangements around vision, leadership and governance dimension of the wider scope audit.

### Planned Audit Response

We will continue to review the arrangements in place in relation to vision, leadership and governance.

# Wider Scope arrangements

## Use of Resources to Improve Outcomes

### 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.

### 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.

### Risk Assessment

As part of our prior year audit, we noted that:

- The Pension Fund Sub-Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance.
- Monitors administration performance against targets.
- Monitors financial performance against targets and other benchmarks.
- Use advisors in decision making
- Evaluate investment manager performances

Based on above we have not identified any significant risk in relation to the Fund's arrangements around use of resources to improve outcomes.

### Planned Audit Response

We will continue to review the relevant arrangements in place including arrangements in place in relation to compliance with the effective of performance reporting requirement as part of the best value audit.

# Appendix

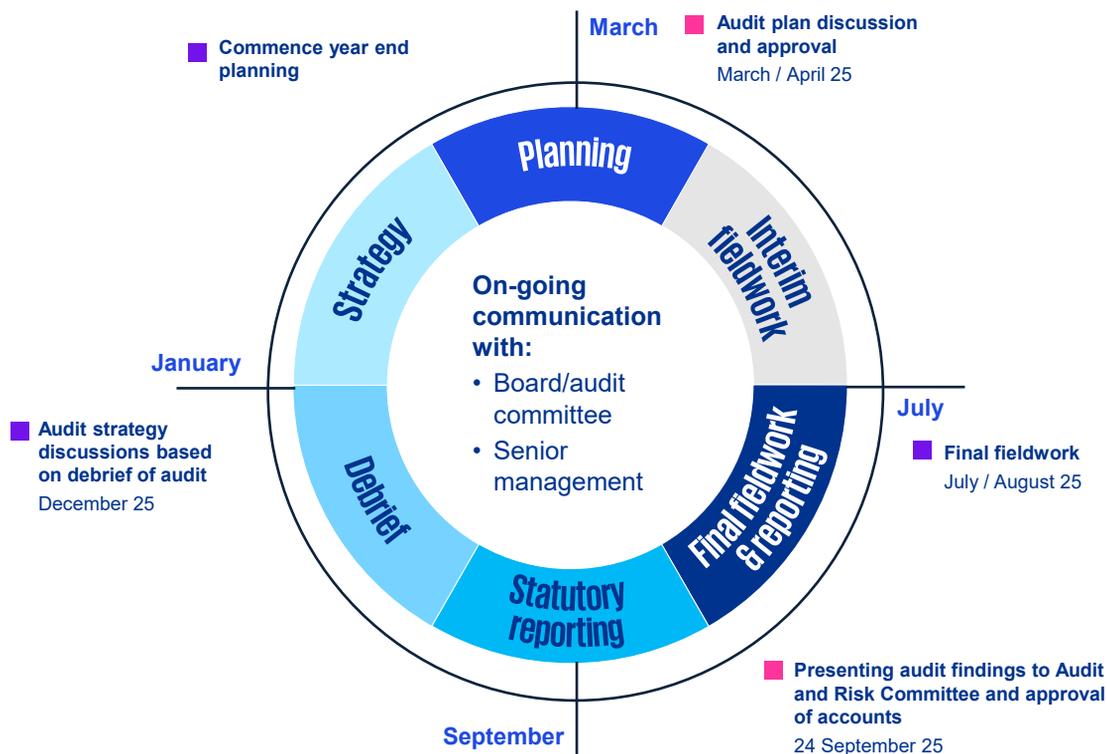
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# Audit cycle & timetable

## Our schedule Jan 2025 – Dec 2025

We have worked with management to generate our understanding of the processes and controls in place at the Fund in its preparation of the Statement of Accounts.

We have agreed with management an audit cycle and timetable that reflects our aim to sign our audit report during September 2025.



**Key:**

■ Timing of A&RC communications

■ Key events

# Mandatory communications

Type	Statement
Management's responsibilities (and, where appropriate, those charged with governance)	<p>Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error.</p> <p>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.</p>
Auditor's responsibilities	Our engagement letter issued by Audit Scotland on 18 May 2022 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 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 10 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 21 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.

# Audit team and rotation

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.

	<p>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.</p>
	<p>Kunal Malhotra is the manager responsible for our audit. He 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.</p>

## Using the work of others and areas requiring specialised skill

We outline below where, in our planned audit response to audit risks, we expect to use the work of others such as Internal Audit or require specialised skill/knowledge to perform planned audit procedures and evaluate results.

Others	Extent of planned involvement or use of work
iRADAR	Our in-house investment team, iRADAR, will review the valuation of the equities held to identify any potential material pricing issues.

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



This will be Julie's 3rd year as engagement lead. She can therefore complete a further 2 years before rotation.

# Audit Fees

Our proposed fees for the year ended 31 March 2025 have been agreed with the management.

Orkney Islands Council Pension Fund	2024/25
	£'000
Auditor Remuneration	45.2
Pooled cost	1.1
Sectoral cap adjustment	(19.5)
<b>TOTAL</b>	<b>26.8</b>

## 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.

# Confirmation of Independence

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 Pension Sub-committee members

## 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.

# Confirmation of Independence (cont.)

## Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Pension Sub Committee and Pension Board.

## Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, 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 Pension Sub Committee and Pension Board 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

KPMG LLP

# KPMG's Audit quality framework

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.

Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.



# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of management

### 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.

# Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

Responsibilities of management
<p><b>Prevention and detection of fraud and irregularities</b></p> <p>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.</p>
<p><b>Corporate governance arrangements</b></p> <p>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.</p>
<p><b>Financial position</b></p> <p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>— such financial monitoring and reporting arrangements as may be specified;</li> <li>— compliance with any statutory financial requirements and achievement of financial targets;</li> <li>— balances and reserves, including strategies about levels and their future use;</li> <li>— how they plan to deal with uncertainty in the medium and longer term; and</li> <li>— the impact of planned future policies and foreseeable developments on their financial position.</li> </ul>
<p><b>Best Value, use of resources and performance</b></p> <p>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.</p>

# Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

## Responsibilities of auditors

### 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.

# Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

Responsibilities of auditors
<b>General principles</b>
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
<b>Independent</b>
<p>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.</p> <p>Our independence confirmation letter (<b>Appendix five</b>) 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.</p> <p>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.</p>
<b>Proportionate and risk based</b>
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.
<b>Quality focused</b>
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.

# Audit Scotland code of audit practice – responsibility of auditors and management (cont.)

<b>Responsibilities of auditors</b>
<p><b>Coordinated and integrated</b></p> <p>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.</p>
<p><b>Public focussed</b></p> <p>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.</p>
<p><b>Transparent</b></p> <p>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.</p>
<p><b>Adds value</b></p> <p>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 where significant risks are identified.</p>

# Responsibility in relation to fraud

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.

## 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 Audit Committee and auditors:

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

## 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.

## 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.

## KPMG's identified fraud risk factors

—Whilst we consider the risk of fraud at the financial statement level to be low for the Board, we will remain alert to 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.



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