

Shetland Islands Council Pension Fund

2023/24 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the members of the Pension Committee and the Controller of Audit
23 September 2024

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Key messages

2023/24 annual report and accounts

- 1 Audit opinions on the annual report and accounts are unmodified.
- 2 The 2023/24 annual report and accounts were certified on 23 September 2024, in line with the agreed audit timetable.

Financial management

- 3 The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.
- 4 Internal audit has given a satisfactory opinion on the Fund's governance, risk management and control framework for 2023/24, but there has been limited progress in addressing previous internal audit recommendations.
- 5 The value of the Fund increased by 16 per cent to £767 million during 2023/24. However, overall investment returns underperformed against the benchmark return set for the year.

Financial sustainability

- 6 The 2023 triennial valuation showed an improved position with the Fund 120 per cent funded, having been assessed as 92 per cent funded in the 2020 valuation. This enabled the Fund to reduce the employers' common contribution rate to 19.6 per cent for the period 2024-2027
- 7 Medium to long term financial planning arrangements are appropriate and effective. There are no concerns over the arrangements for financial sustainability.

Vision, leadership and governance

- 8 The Fund has effective and appropriate arrangements in place that support good governance and scrutiny of decision-making.
- 9 The Fund needs to identify and implement the changes required to ensure compliance with the Pensions Regulator's new General Code of Practice.

Use of resources to improve outcomes

- 10 The pension administration performance against key targets declined from the previous year.

- 11** The impact of global markets' performance affected annual returns. Despite performing behind its benchmarks, the Shetland Islands Council Pension Fund was the best performing Scottish local government pension fund in terms of returns on investments.
- 12** The administering authority has appropriate arrangements in place for securing Best Value at the Fund.

Introduction

1. This report summarises the findings from the 2023/24 annual audit of Shetland Islands Council Pension Fund (the Fund) and will be published on Audit Scotland's website: www.audit-scotland.gov.uk
2. The scope of the audit was set out in our annual audit plan presented to the May 2024 meeting of the Pension Committee. This annual audit report comprises the significant matters arising from an audit of the Fund's annual report and accounts and conclusions on the wider scope areas set out in the [Code of Audit Practice](#).
3. We would like to thank committee members, senior management, and other staff, particularly those in finance, for their cooperation and assistance during the course of the audit.

Responsibilities and reporting

4. The administering authority (Shetland Islands Council) of the Fund has responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts for the Fund in accordance with proper accounting practices. Shetland Islands Council is also responsible for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.
5. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973; the [Code of Audit Practice](#) and supplementary guidance and International Standards on Auditing in the UK.
6. This report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation. Weaknesses or risks identified in this report are only those which have come to our attention during our audit work and may not be all that exist. Communicating these does not absolve management of the administering authority of its responsibility to address the issues raised and to maintain adequate systems of control.

Auditor Independence

7. 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 2023/24 audit fee of £37,280, as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity or independence.

1. Audit of 2023/24 annual report and accounts

Public bodies are required to prepare an annual report and accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship public funds.

Audit opinions on the annual report and accounts are unmodified.

The 2023/24 annual report and accounts were certified on 23 September 2024, in line with the agreed audit timetable.

Audit opinions on the annual report and accounts are unmodified

8. The Pension Committee approved the annual report and accounts for the Fund for the year ended 31 March 2024 on 23 September 2024. The independent auditor's report included the following audit opinions on the annual report and accounts:

- 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 consistent with the financial statements and properly prepared in accordance with the applicable requirements.

The 2023/24 annual report and accounts were certified on 23 September 2024, in line with the agreed audit timetable

9. We received the unaudited annual report and accounts on 27 June 2024, in line with the agreed audit timetable. The accounts and working papers presented for audit were of a good standard and management and finance staff provided excellent support to the team during the audit process. This helped ensure that the final accounts audit was completed in line with the audit timetable, with the 2023/24 annual report and accounts certified on 23 September 2024.

Our audit approach and testing were informed by the overall materiality level of £15.3 million

10. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality although some issues may be

considered material by their nature, and it is ultimately a matter of the auditor's professional judgement.

11. Our initial assessment of materiality was carried out during the planning phase of the audit and based on the financial results reported in the Fund's audited 2022/23 annual report and accounts, we set overall materiality at £13.0 million. Materiality levels were reported in our annual audit plan to the May 2024 meeting of the Pension Committee.

12. On receipt of the unaudited 2023/24 annual report and accounts we recalculated our materiality levels based on the financial results for the year ended 31 March 2024. These are detailed in [Exhibit 1](#).

Exhibit 1

Materiality levels for the 2023/24 audit

Materiality level	Amount
Overall materiality: This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set based on our assessment of the needs of the users of the financial statements and the nature of the Fund's operations.	£15.3 million
Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this could indicate that further audit procedures are required. Using our professional judgement, we have assessed performance materiality at 65 per cent of overall materiality.	£9.9 million
Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£250 thousand

Source: Audit Scotland

Our audit identified and addressed the risks of material misstatement

13. [Exhibit 2](#) sets out the significant and non-significant risks of material misstatement to the financial statements. It also 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 and non-significant risks of material misstatement

Nature of risk	Audit Response	Conclusion
Significant risks of material misstatement		
<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"> Assessed the design and implementation of controls over journal entry processing. Made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. We used data analytics to consider all journals and substantively tested a sample of higher risk year end journals. Considered the need to test journal entries and other adjustments during the period. Evaluated any significant transactions outside the normal course of business. Assessed any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. Substantively tested income and expenditure transactions around the year-end to confirm they were accounted for in the correct financial year. Focussed testing of accounting accruals and prepayments. 	<p>No significant control weaknesses identified through audit work.</p> <p>Journal testing of a sample of higher risk transactions at year-end and other transactions through the year did not identify any issues.</p> <p>No issues identified relating to unusual journal activity.</p> <p>No significant transactions outside normal course of business were identified.</p> <p>No changes were made to methodology or assumptions used to prepare accounting estimates in year.</p> <p>Conclusion: We did not identify any instances of management override of controls during our audit.</p>
<p>2. Level 3 investment assets valuation</p> <p>Investments represented 11.5% of the Fund's investments at 31 March 2023 and are not based on observable market data but rely on</p>	<ul style="list-style-type: none"> Assessed the competence, capabilities, and objectivity of the fund managers in line with ISA 500. Critically assessed the Pension Fund's arrangements for arriving at the valuation of level 3 investments, including 	<p>No issues identified in our assessment of fund managers as management's experts.</p> <p>We identified one area where the Fund's arrangements for arriving at the valuation</p>

Nature of risk	Audit Response	Conclusion
<p>investment manager valuations involving significant application of judgment which might be impacted by delays in valuation data and reaction to environmental factors.</p> <p>The subjectivity involved represents increased risk of material misstatement in the financial statements.</p>	<p>the use of experts in undertaking the valuation.</p> <ul style="list-style-type: none"> Confirmed year end valuations to valuation reports and/or other supporting documentation, including third party confirmation. Reviewed the relevant investment managers' controls reports for qualifications or exceptions that may affect the audit risk. Reviewed the arrangements in place at the Pension Fund to assess investment managers' governance arrangements. Reviewed the disclosures included in the accounts to ensure these are adequate in directing the user of the accounts to areas with significant judgement and estimation uncertainty. 	<p>of level 3 investments could be improved (see paragraph 31) however additional assurances were obtained to support the valuation.</p> <p>Investment valuations were agreed to independently sourced fund manager reports.</p> <p>A review of investment managers' controls reports was completed, and no exceptions noted.</p> <p>No issues were identified in our review of the arrangements in place at the Fund for assessing investment managers' governance arrangements.</p> <p>Disclosures in the accounts were reviewed and considered to be adequate.</p> <p>Conclusion: Satisfactory, no issues identified with level 3 investment asset valuations</p>

Other risks of material misstatement in the annual accounts

3. Actuarial valuation of pension liability

The annual accounts include a disclosure note setting out the SIPF's liability for future retirement benefits. This information is provided by the SIPF's actuary. The actuary's valuation depends on a range of financial and demographic estimations

- Assessed the competence, capabilities, and objectivity of the actuary in line with ISA 500.
- Review the information provided to the actuary by the Fund.
- Review the assumptions used by the actuary to reach the valuation of future retirement benefits
- Review officers' arrangements for ensuring the completeness and accuracy of

No issues were identified in our assessment of the actuary as management's expert.

Arrangements for provision of data to the actuary were deemed satisfactory.

The assumptions used within the actuarial

Nature of risk	Audit Response	Conclusion
about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.	professional estimations for pensions.	valuation were within expected ranges. Management considerations in relation to the actuary were reviewed and considered reasonable. Conclusion: Satisfactory, no issues identified with the valuation of the disclosed pension liability.

Source: Audit Scotland

We reported the significant findings from the audit prior to the annual report and accounts being approved and certified

14. Under International Standard on Auditing (UK) 260, we are required to communicate significant findings from the audit, including our view about the qualitative aspects of the body's accounting practices, to those charged with governance prior to the audited annual report and accounts being approved and certified.

15. The Code of Audit Practice also requires us to highlight key audit matters which are defined in ISA (UK) 701 as those matters judged to be of most significance.

16. The significant findings are summarised in [Exhibit 3](#).

17. Our audit also identified other presentation and disclosure issues which were discussed with management. These were all adjusted in the audited annual report and accounts, and none were significant enough to require to be separately reported under ISA 260.

Exhibit 3

Significant findings and key audit matters from the audit of the annual report and accounts

Issue	Resolution
1. Blackrock transfer of investments During 2023/24, Blackrock investments totalling £255 million in a World Ex UK fund and a UK fund were sold and re-invested in a MSCI World fund.	Note 13a in the audited accounts has been amended to reduce the value of both purchases and sales during the year by £412 million.

Issue	Resolution
<p>As part of the transaction, Blackrock sought to minimise transaction charges by identifying common sub-funds within both funds. They undertook a number of transactions within a transition account to move these common sub-funds, then transacted the subsequent sale and purchase of main funds. Disclosures in the unaudited accounts recognised all stages of these transactions, including £412 million sales and purchases relating to the common sub-fund transfer. The transfer into the transition account and transfer out of the transition account should not be recognised as fund purchases and sales. Only the reorganisation of the investments through actual sales and purchases within the transition account should be recognised. Purchases and sales were both overstated by £412 million in the unaudited accounts.</p>	<p>This change does not impact any other notes to the accounts, or the total shown in the Net Asset Statement.</p>

Source: Audit Scotland

Misstatements of £0.875 million were identified within the financial statements. This was lower than our performance materiality and we did not need to revise our audit approach.

18. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected but the final decision on making the correction lies with those charged with governance.

19. Other than the corrected error detailed as a significant finding in [Exhibit 3](#), our audit identified one misstatement above the reporting threshold. This was not corrected by management in the audited annual report and accounts.

20. The unaudited accounts were prepared based on fund manager reports as at 31 March 2024, except for Permira where the most recent report (as at 31 December 2023) was used by the Fund and adjusted for known transactions. The 31 March 2024 Permira report was subsequently received by the Fund during the audit, and a difference of £0.875 million in the cash deposit figure was identified between the unaudited accounts and the supporting report.

21. This misstatement is below our performance materiality of £9.9 million and therefore we are satisfied that this error does not have a material impact on the financial statements.

22. We have reviewed the nature and cause of this misstatement and concluded that it arose due to the timing of the receipt of year end reports from the fund manager. The issue is isolated and identified in its entirety and does not indicate further systemic error. We did not need to revise our audit approach.

Substantial progress was made on prior year recommendations

23. Our 2022/23 annual audit report included four recommendations for improvement. The Fund has made substantial progress in implementing these. An update on progress with these recommendations is set out in [Appendix 1](#).

2. Financial management

Financial management means having sound budgetary processes, and the ability to understand the financial environment and whether internal controls are operating effectively.

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

Internal audit has given a satisfactory opinion on the Fund's governance, risk management and control framework for 2023/24, but there has been limited progress in addressing previous recommendations.

The value of the Fund increased by 16 per cent to £767 million during 2023/24. However, overall investment returns underperformed against the benchmark return set for the year.

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

24. The Executive Manager (Finance) for Shetland Islands Council is the Proper Officer responsible for Shetland Islands Council Pension Fund. The financial regulations of Shetland Islands Council, as administering authority, apply to the Fund. We consider these to be current, comprehensive and support good financial management.

25. The Shetland Islands Council Pension Fund Committee receives administration and performance reports at its quarterly meetings. These reports are comprehensive and include fund performance trends and investment manager performance against benchmarks, and movements in asset allocations. From attendance at committee meetings, we concluded that reports presented to members are subject to appropriate review and scrutiny.

26. Performance reporting in the annual accounts for 2023/24 includes enhanced narrative on investment performance and data on individual fund manager performance against annual benchmarks.

27. Overall, we have concluded that the Fund has appropriate and effective financial management arrangements in place, including comprehensive reporting of investment performance.

Financial systems of internal control operated effectively during 2023/24

28. 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 (including those relating to IT). Our objective is to gain assurance that Shetland Islands Council Pension Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

29. Our work in 2023/24 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, Shetland 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 Shetland Islands Council.

30. 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 record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements. One minor weakness was identified regarding the monthly reconciliations performed between the custodian report valuations and the ledger:

- We identified that monthly reconciliations were not completed in the period from September to December 2023. This was due to a change in the way the reconciliation is performed. The Fund has moved from using custodian figures in the reconciliation to using fund manager reports. A four-month reconciliation was carried out using the fund manager figures and reconciliations have returned to being produced monthly. The control is now operating as expected.

31. We identified two areas where existing controls could be improved:

- Review of user access to banking system – the annual review of user access to the banking system was not documented by the Fund
- Management assurances over fund managers – the service auditor report for Permira does not include consideration of investment valuation.

Recommendation 1

Annual reviews of user access to bank accounts should be documented to evidence completion.

Recommendation 2

The Fund should seek to gain annual confirmation from Permira that their advisers have not identified any significant issues with the valuations.

The value of the Fund increased by 16 per cent to £767 million during 2023/24. However, overall investment returns underperformed against the benchmark return set for the year

32. The Fund's performance in 2023/24 is summarised in [Exhibit 4](#). This shows that the net assets of the Fund increased from £660 million at 31 March 2023 to £767 million at 31 March 2024. This £107 million (16.3 per cent) increase in net assets was mainly attributable to increases in the value of managed funds (£32 million) and infrastructure investments (£67 million) during the year. These market value changes contributed to a positive annual fund investment return for the year of 15 per cent. However, this was below the 16.8 per cent benchmark return set for the year.

33. [Exhibit 4](#) also shows that the overall funding level of the Fund has increased to 124 per cent at 31 March 2024 using assumptions consistent with those adopted for the 2023 triennial valuation. This was calculated by taking the closing net assets as a proportion of promised retirement benefits at 31 March 2024. Further commentary on this is included within the [Financial sustainability](#) section of this report.

Exhibit 4

Assets, funding level and investment performance

Increase in net assets	Funding level	Investment performance
<p>£767.986 million</p> <p>Closing net assets as at 31 March 2024 (+16.3%)</p>	<p>124%</p> <p>At 31 March 2024 (interim valuation using assumptions consistent with those adopted for the 2023 triennial valuation)</p>	<p>8.7%</p> <p>Average annual return on investments over 5 years</p>
<p>£660.467 million</p> <p>Opening net assets as at 1 April 2023</p>	<p>120%</p> <p>As at 31 March 2023 (based on 2023 triennial valuation)</p>	<p>15%</p> <p>Return on investments 2023/24</p>

Source: Shetland Islands Council Pension Fund 2023/24 Annual Report and Accounts

Longer-term outlook remains uncertain with a risk that there will be further fluctuations in the Fund value in future years

34. When considering the overall investment performance of the Fund during 2023/24, as shown in [Exhibit 4](#), it is important to recognise the impact of world

events on financial markets and investments. The global impact of the conflict in Ukraine and other events has significantly increased market volatility.

35. The Fund's overall investment return was 15 per cent during 2023/24 with an increase in net asset of £107 million (16.3 per cent). While the Fund's current financial position is strong, we would caution that the Fund underperformed against their benchmark by 1.8 per cent during 2023/24 and the longer-term outlook remains uncertain. There is a risk that there will be further market volatility and fluctuations in the value of investments in future years as the long-term impact of recent world events becomes clearer.

Internal audit has given a satisfactory opinion on the Fund's governance, risk management and control framework for 2023/24, but there has been limited progress in addressing previous internal audit recommendations

36. The Fund's internal audit function is carried out by Audit Glasgow as part of their contract with Shetland Islands Council. Audit Glasgow presented their Annual Audit Report to the Shetland Islands Council's June 2024 Audit Committee meeting. Their overall opinion was that reasonable assurance could be placed upon the adequacy and effectiveness of the governance and control environment which operated during 2023/24.

37. However, Internal Audit noted there were 54 internal audit recommendations outstanding as at June 2024, with some of these being significantly overdue from the originally planned implementation date. A number of these recommendations related specifically to the Fund, including 3 medium risks around compliance with cyber security principles, and 2 medium risks in relation to the Altair system. The target implementation for these recommendations has been pushed back by 12 months due to resource constraints and other work priorities. Pension Fund committee members, as those charged with governance, should ensure they understand and accept the risks associated with delaying improvement actions.

The Fund has adequate arrangements in place to prevent and detect fraud, error and irregularities, bribery, and corruption

38. In the public sector there are specific fraud risks, including those relating to pension claimants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery, and corruption.

39. The Fund relies on the administering authority's arrangements for the prevention and detection of fraud and corruption. These include a Code of Conduct for members and officers, Whistleblowing Policy and an Anti-Fraud Strategy.

40. The administering authority has a Code of Conduct for council employees. This formal review date for this Code was March 2023 but it is still outstanding with no current timescale for completion. This matter has been reported through our audit of Shetland Islands Council. Our overall conclusion is that the Fund

has adequate arrangements in place to prevent and detect fraud, error and irregularities, bribery, and corruption.

3. Financial sustainability

Financial Sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

The 2023 triennial valuation showed an improved position with the Fund 120 per cent funded, having been assessed as 92 per cent funded in the 2020 valuation. This enabled the Fund to reduce the employers' common contribution rate to 19.6 per cent for the period 2024-2027

Medium to long term financial planning arrangements are appropriate and effective. We currently have no concerns about the financial sustainability of the Fund or the viability of the funding strategy.

The 2023 triennial valuation showed an improved position with the Fund 120 per cent funded, having been assessed as 92 per cent funded at the time of the 2020 valuation.

41. There is a statutory requirement for local government pension funds to undertake a full actuarial valuation of assets and liabilities every three years. This is referred to as a triennial valuation.

42. The most recent triennial funding valuation took place across Local Government Pension Schemes in 2023/24 based on data as at 31 March 2023. The main purpose of the valuation is to review the financial position of each fund and to set appropriate contribution rates for each employer for the upcoming three-year period as part of the fund's overall funding strategy. The results of the full triennial valuation of the Fund were reported to the Pension Fund Committee in March 2024.

43. The results of the 2023 triennial valuation of the Fund showed a funding level of 120%, a significant improvement from the 2020 level of 92%. This meant that overall, the Fund had a surplus of assets over liabilities and that the fund assets were sufficient to meet 120% of its liabilities.

The Fund reduced the employers' common contribution rate to 19.6 per cent for the period 2024/25-2026/27

44. Following the triennial valuation in 2023, the actuary agreed employer contribution rates with individual employers from 1 April 2024. The results of the 2023 valuation enabled the Fund to reduce the employer's common contribution rate - the weighted average across all employers - from 22 per cent to 19.6 per cent for the period 2024/25-2026/27.

45. While this reduced contribution rate will decrease the amount paid in to the Fund through employer contributions over the next three years, we do not believe this presents any risk to the long-term financial sustainability of the Fund.

Medium to long term financial planning arrangements are appropriate and effective

46. 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 2023. The Pension Fund's investment strategy is reviewed every five years as a long-term investment view is taken. Results of actuarial valuations which are every three years are used as a check that the Pension Fund is in a healthy situation, and when there are unexpected large changes to the Pension Fund's situation then this is given due consideration.

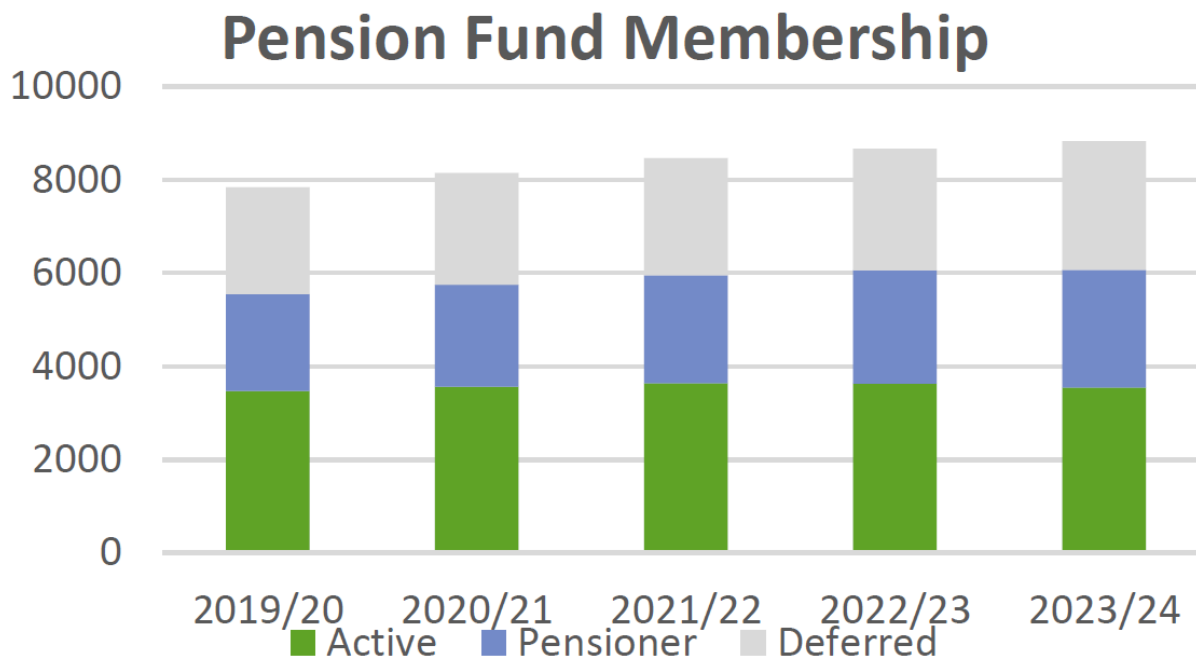
47. The current Investment Strategy Review covers the five-year period to 2027. The significant change to the funding level shown in the 2023 triennial valuation prompted discussions about the appropriateness of the investment strategy in maintaining this fully funded position. A 'health check' of the Pension Fund's investment strategy was subsequently undertaken to ensure that the current mandates and fund manager portfolios are structured to continue to deliver the investment return objectives in the future.

48. A strategy paper was presented to the Pension Fund Committee in June 2024, proposing some changes to the way in which the Pension Fund invests its investments to better reflect the Pension Fund's long-term objectives. The proposed new investment strategy is not a significant change to the existing investment strategy. It still maintains a growth strategy while reducing the level of equity risk and using the benefit of investing in illiquid assets to achieve more stable high returns, to ensure the Pension Fund's objectives are achieved.

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

49. The Fund is a multi-employer fund with Shetland Islands Council and nine other admitted and scheduled bodies. The current membership profile is shown at [Exhibit 5](#). 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 5 Shetland Islands Council Pension Fund membership



Source: Shetland Islands Council Pension Fund 2023/24 audited financial statements

50. Membership of the fund increased by 168 to 8830 members at 31 March 2024, an increase in membership of 1.9%. The impact of auto-enrolment continues to contribute to the increase in employee members.

51. In 2023/24 the number of pensioners receiving a pension from Shetland Islands Council Pension Fund increased by 99 and the number of pensioner members continues to increase steadily each year. The number of active members outweighs the number of pensioners but the ratio of active members to pensioners has reduced over the past five years. Shetland Islands Council Pension Fund has considered this as part of its investment strategy and is further diversifying its investment structure to increase investment in income generating assets.

52. Cash flows from dealings with members continue to be positive, with more received from contributions than paid out in benefits. However, the continued growth in pensioner numbers within the Fund's membership makes funding pension payments increasingly challenging. Over the long term, the cash flow position will impact on the investment strategy if the ratio of active to retired members continues to decrease. However, the current funding strategy is providing sufficient member contributions to cover pension payments.

We currently have no concerns about the financial sustainability of the Fund or the viability of the funding strategy

53. Based on the triennial valuation which showed that the Fund is 120 per cent funded (paragraphs [41.](#) to [43.](#)), and the healthy net asset position at 31 March 2024 ([Exhibit 4](#)), we have no concerns about the current financial sustainability of the Fund or the viability of the funding strategy.

4. Vision, leadership and governance

Public sector bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

The Fund has effective and appropriate arrangements in place that support good governance and scrutiny of decision-making.

The Fund needs to identify and implement the changes required to ensure compliance with the Pensions Regulator's new General Code of Practice

Governance arrangements are appropriate and operate effectively

54. Shetland Islands Council as the administering body of the pension fund has delegated responsibility for governance of the Fund to the Pension Fund Committee. The committee is supported by the Pension Board, which comprises trade union representatives and employer representatives. These groups work within the overarching governance framework of the Council.

55. The Pension Fund committee is responsible for preparing, publishing and maintaining key strategies and reports for the Fund. They are also responsible for the development and monitoring of investment strategy. The Pension Board is responsible for ensuring compliance with Pension Regulator rules and monitoring the work of the Pension Fund Committee.

56. The main functions of the Fund are the management of investments and the administration of scheme benefits. These functions are carried out in accordance with the Local Government Pension Scheme (Scotland) regulations which are statutory instruments made under the Superannuation Act 1972 and Public Service Pensions Act 2013.

57. The Fund's governance arrangements have been set out in the Annual Governance Statement in the annual report and accounts. We have reviewed these arrangements and concluded that governance arrangements are appropriate and support effective scrutiny, challenge and decision making.

The Fund had no reportable breaches of the Pensions Regulator Public Service Code regulations during 2023/24

58. 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. Management has confirmed that there were no reportable breaches during 2023/24.

59. The Fund has carried out a governance compliance self-assessment for 2023/24 and concluded it was compliant with the Code and has identified no significant governance issues to be reported. Our audit work has not identified any issues with this assessment.

The Fund needs to identify and implement the changes required to ensure compliance with the Pensions Regulator's new General Code of Practice

60. The Pensions Regulator's new [General Code of Practice](#) sets out the standards and expectations for the governance and management of occupational pension schemes in the UK. The code, which came into force on 28 March 2024, consolidated and replaced 10 previous codes of practice. This comprehensive code aims to ensure that pension schemes are managed effectively and in the best interests of their members. Key aspects of the code include:

- **Governance Requirements:** It outlines the necessary governance structures, systems, and controls that pension schemes should have in place.
- **Funding and Investment:** It details investment governance and strategy requirements, including environmental and social duties.
- **Administration:** It covers the handling of information, record-keeping, and monitoring contributions.
- **Communications and Disclosure:** It specifies the communications that governing bodies must produce for scheme members and the information that should be publicly available.
- **Reporting:** It includes requirements for reporting to The Pensions Regulator, such as scheme returns and breaches of the law.

61. The Fund carried out a governance compliance self-assessment for 2023/24 and concluded it was compliant with the previous Code and identified no significant governance issues to be reported. However, the new General Code of Practice introduces obligations not covered by the previous codes. The Pensions Regulator expects all schemes to be aware of where governance and administration arrangements may be below required standards, and to be developing a clear and realistic plan to address any areas of non-compliance.

Recommendation 3

Management needs to identify and implement the changes required to ensure the Fund's compliance with the Pensions Regulator's new General Code of Practice.

Performance reporting and other information in the accounts provide details of the Fund over the year

62. The Management Commentary included in the annual report and accounts should provide information on a body, its main objectives and the principal risks faced. It must provide a fair, balanced and understandable analysis of a body's performance and is essential in helping stakeholders understand the financial statements.

63. All required disclosures were covered in the Management Commentary or via links to other areas of the annual report and accounts. We recommended several narrative improvements to management to provide additional context or increase transparency of the Management Commentary. These were accepted and amended in the audited annual report and accounts.

Reporting on climate change arrangements has improved

64. The Scottish Parliament has set a legally binding target of becoming net zero by 2045. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change. For the pension fund, the responsibility for meeting these targets lies with the administering authority (Shetland Islands Council). Shetland Islands Council approved a Climate Change Strategy and Action Plan in December 2023.

65. While the administering authority is responsible for meeting the above targets, the Fund should be working towards monitoring and reporting on climate-related disclosures. During the year the Pension Fund surveyed its fund managers on their strategic climate change plans, their approach to assessing and targeting change, and how climate change is reflected in the portfolio/investments that the Fund has an interest in. Responses from fund managers were collated and included as an appendix to the accounts. There is scope to build on this further and improve disclosures around climate change and responsible investing.

5. Use of resources to improve outcomes

Public sector 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.

The pension administration performance against key targets declined from the previous year.

The impact of global markets' performance affected annual returns. Despite performing behind its benchmarks, the Shetland Islands Council Pension Fund was the best performing Scottish local government pension fund in terms of returns on investments.

The administering authority has appropriate arrangements in place for securing Best Value at the Fund.

The pension administration performance against key targets declined from the previous year

66. The Shetland Islands Council Pension Fund Committee meets on a regular 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.

67. Performance against pension administration targets has been reported in the Management Commentary of the [2023/24 Annual Report and Accounts](#). Performance has declined in 2023/24. In 2022/23, seven of the nine key performance indicators were achieved, with the remaining 2 indicators within 4 per cent of the overall target. In 2023/24 the number of indicators achieved within target dropped to four. Three indicators - processing of new starts, leavers and retirement estimates - achieved over 95 per cent of target. However, only 88 per cent of transfer in quotes were processed the 2-month target date, with transfer out quotes achieving 86 per cent of target.

The impact of global markets' performance affected annual returns. Despite performing behind its benchmarks, the Shetland Islands Council Pension Fund was the best

performing Scottish local government pension fund in terms of returns on investments

68. The Fund appoints several external investment managers. Individual investment manager performance is reviewed regularly by the Shetland Islands Council Pension Fund Committee and the Fund's investments team also carries out annual reviews for each appointed fund manager.

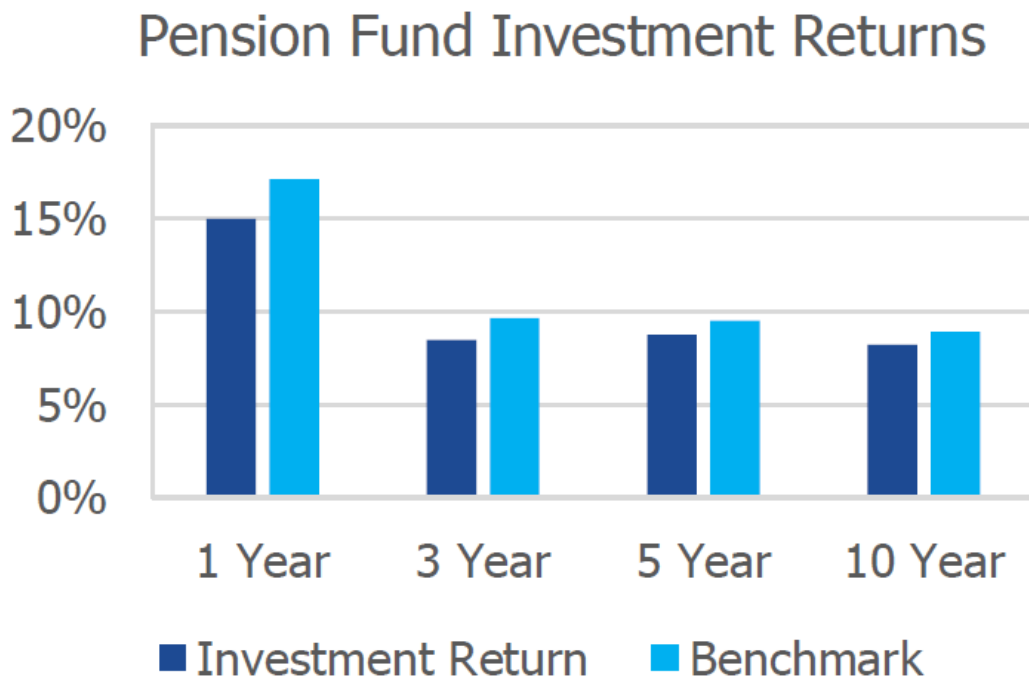
69. Financial markets have remained volatile; however, returns against most asset classes, especially equities, were positive by the end of 2023/24.

70. 2023/24 was a more positive year for Scottish local government pension funds in terms of returns on investments, after a challenging year in 2022/23 when most industry benchmarks delivered negative performance. Across Scottish funds investment performance ranged from 5.5 per cent to 15 per cent (compared to returns ranging from minus 6 per cent to 1 per cent in 2022/23).

71. [Exhibit 6](#) shows that over the year, the Fund generated a return of 15% against a benchmark of 16.8%. Despite performing below its benchmark for the year, the Fund was the best performing Scottish fund in 2023/24.

Exhibit 6

Pension Fund investment performance against benchmarks



Source: Shetland Islands Council Pension Fund 2023/24 audited financial statements

Investment performance over the last 12 months was varied, with two portfolios exceeding their benchmarks during 2023/24

72. Fund managers' performance is reported on a quarterly basis to the Pension Fund Committee and Pension Board. These reviews include details of investment performance for each portfolio, the physical movement of funds and any changes from the investment strategy. This allows members of the Pension Fund Committee and Pension Board to effectively scrutinise investment performance of each fund manager.

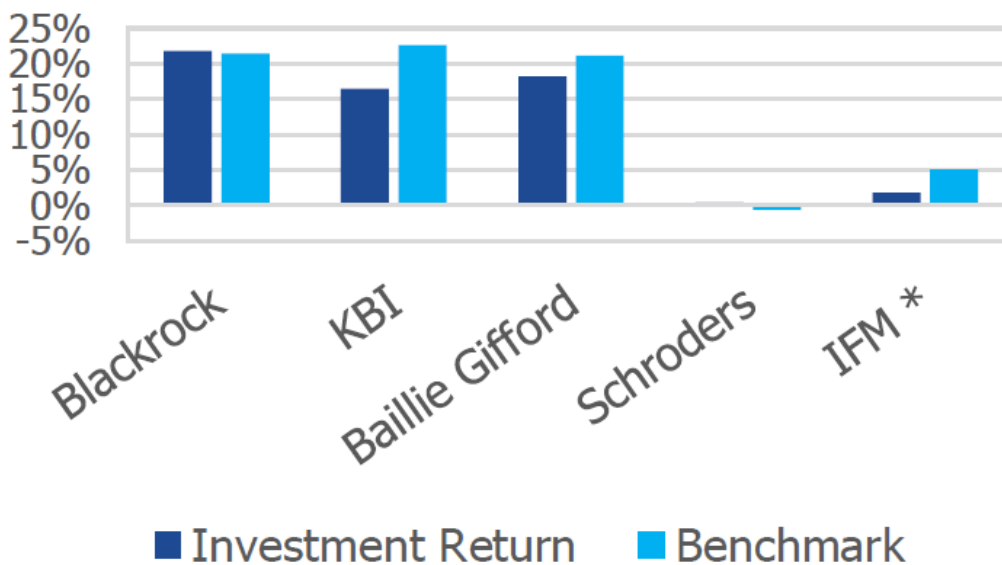
73. In addition to the quarterly reviews, the Executive Manager (Finance) produces an Annual Investment Review, which includes a comprehensive breakdown of performance for each of the six fund managers. Performance is measured against a specific fund benchmark, which is made up of market indices of the countries where the fund manager invests. Performance is assessed against both prior year and previous 5-year benchmarks.

74. As shown in [Exhibit 7](#), two of the six investment mandates reported above benchmark returns, and three reported below benchmark returns, for the year. Permira to date has only received around 43% of its mandate, and due to the nature of the investments, performance figures were not yet available.

Exhibit 7

Investment mandate performance against benchmark 2023/24

Investment Returns by Fund Manager for year ended 31 March 2024



*IFM figures are for 6 months only

Source: Shetland Islands Council Pension Fund Annual Report and Accounts 2023/24

The administering authority has appropriate arrangements in place for securing Best Value at Shetland Islands Council Pension Fund.

75. The administering authority (Shetland Islands Council) has responsibility for ensuring that its business, including that of the Fund, is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively. The council also has a statutory duty to make arrangements to secure Best Value, which are subject to audit.

76. The outcome of audit work on the administering authority's Best Value arrangements is reported in the Shetland Islands Council Annual Audit Report. There were no findings from this work that suggested weaknesses in the arrangements in place to secure Best Value that are directly applicable to the pension fund.

Appendix 1: Action plan

2023/24 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Annual review of bank account user access</p> <p>A prior year recommendation was made for the Fund to implement an annual review of bank account user access to confirm system access permissions are appropriate. This was implemented during 2023/24. However, this was not adequately documented and evidenced by the Fund.</p> <p>Risk – without a clearly documented audit trail, the Fund cannot demonstrate that its internal controls are operating effectively, and there may be a risk of inappropriate access to the system.</p>	<p>The Fund should undertake an annual review of user access to banking system, including specific detail on the appropriateness of users and their roles and ensure a clear audit trail through the documentation of the review.</p> <p>Paragraph 31.</p>	<p>An agreed procedure note for this will be developed and a clearly documented audit trail will be kept of the user checks carried out.</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: March 2025</p>
<p>2. Management assurances over Permira.</p> <p>Kroll Advisory Ltd, a third-party valuation expert, review the Permira valuations on a quarterly basis and concluded there were no material issues with Permira investment valuations at 31 March 2024, however their findings are not routinely communicated to the Fund.</p> <p>Risk – issues with Permira investment valuations may not be identified in a timely manner.</p>	<p>As part of their year-end representations from fund managers the Fund should seek confirmation from Permira of the outcome of the Kroll Advisory Ltd review of valuations.</p> <p>Paragraph 31.</p>	<p>Management will seek confirmation from Permira of the outcome of third-party reviews conducted on the valuation of Permira's investments.</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: March 2025</p>
<p>3. Pensions Regulator General Code of Practice</p> <p>The Pensions Regulator's new General Code of Practice sets out the standards and expectations for the governance</p>	<p>Management needs to identify the changes required to ensure the Fund's compliance with the Pensions Regulator's new General Code of</p>	<p>Management will develop an action plan to address the requirements of the Pensions Regulator's new General Code of</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>and management of occupational pension schemes in the UK. The code, which came into force on 28 March 2024, consolidated and replaced 10 previous codes of practice. This comprehensive code aims to ensure that pension schemes are managed effectively and in the best interests of their members.</p> <p>Risk: The Fund's existing governance arrangements, structure and operating model do not meet the requirements of the new Code.</p>	<p>Practice and develop an action plan to deliver these.</p> <p>Paragraph 61.</p>	<p>Practice. This will also be presented for review to the Pension Board/Committee for their input and oversight.</p> <p>Responsible officer: Executive Manager – Governance & Law, and Executive Manager - Finance</p> <p>Agreed date: March 2025</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation and Agreed actions	Progress
<p>PY1. Custodian and Fund manager reconciliations</p> <p>Final accounts working papers do not currently document management assessment of the reasonableness of valuation differences in the reconciliation process between fund manager and the custodian.</p> <p>Risk – investment valuation estimates in the financial statements are not properly assessed and reported.</p>	<p>Recommendation - Management consideration of the reasonableness of valuation differences in the custodian and fund manager reconciliation should be fully documented, including the tolerances used in the assessment.</p> <p>Agreed action – In line with the recommendation, the process of reconciling the custodian valuation to fund manager valuations, including agreed tolerances, will be documented.</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: June 2024</p>	<p>Complete</p> <p>A management paper reconciling the fund manager valuations to the custodian valuations was completed at year end, including agreed tolerances. This paper will now form part of the annual working papers for the Pension Fund accounts, including a clear document trail demonstrating management's assessment and sign-off of this.</p>
<p>PY2. Investment performance reporting- Fund manager analysis</p> <p>The current method of performance reporting does</p>	<p>Recommendation - Current investment reporting within the annual report and accounts should be expanded to include analysis</p>	<p>Complete</p> <p>The Management Commentary has been updated to include an additional table reflecting</p>

Issue/risk	Recommendation and Agreed actions	Progress
<p>not give sufficient detail to enable analysis of performance at a fund manager level. There is also no disclosure of targets agreed with fund managers.</p> <p>Risk – There is a risk that users of the accounts cannot make an informed judgement on investment performance without this level of detail around fund manager performance.</p>	<p>at the fund manager level of performance against targets and benchmark as appropriate.</p> <p>Agreed action – Additional disclosure of Fund Managers' overall performance will be included in the 2023/24 annual accounts. The merit and structure of this is to be determined.</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: June 2024</p>	<p>Fund Manager performance against benchmarks, as well as additional narrative on the overall investment performance.</p>
<p>PY3. Bank system user access</p> <p>Current checks on user access for the bank system Review of bank account user access should be undertaken annually to confirm system User access is checked on an ad hoc basis (when staff join, leave or change roles).</p> <p>Risk – system access may not be limited to appropriate users.</p>	<p>Recommendation - review of bank account user access should be undertaken annually to confirm system access permissions are appropriate.</p> <p>Agreed actions - In line with the recommendation, an annual review will be carried out where required (if an ad hoc check has not been done within the previous 12 months).</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: March 2024</p>	<p>Complete</p> <p>An annual review of user access is now carried out, with any additional checks and changes throughout the year documented as they occur.</p> <p>In line with the recommendation to improve existing controls outlined in Paragraph 31, the Fund has agreed to ensure a clearly documented audit trail which demonstrates the discussion and sign-off of this review.</p>
<p>PY4. Climate change reporting</p> <p>The narrative included for climate change in the 2022/23 accounts could be improved by including a greater depth of analysis. This could include risk analysis based on sector of investment, or range estimates on future impact to the fund's investments.</p>	<p>Recommendation - The Fund should consider whether it needs to appoint an ESG partner to help it understand and report on climate change and other environmental, social and governance matters.</p> <p>Agreed actions - Discussions will be held with other Pension Funds and fund managers on their reporting</p>	<p>Complete</p> <p>As part of the 2023/24 annual accounts process, Fund managers were surveyed on their strategic and practical approach in relation to climate change, and how this is reflected in the portfolio/investments that the Pension Fund has an active interest in. The information</p>

Issue/risk	Recommendation and Agreed actions	Progress
<p>Risk – without adequate analysis of the potential risks faced by the fund from the climate emergency, medium and long-term planning will become less effective.</p>	<p>of ESG considerations, to look at best practice in this area and how narrative about climate change in relation to the Fund’s investments can be improved. Use of an ESG partner would incur additional costs on the Pension Fund, the value it adds would need to be taken into account when considering the use of an ESG partner.</p> <p>Responsible officer: Executive Manager - Finance</p> <p>Agreed date: June 2024</p>	<p>has been included as an appendix to the accounts.</p> <p>This is seen as an initial step and it is clear that this is the basis for further work in future accounts. This could include the appointment of an ESG partner although there is a desire to see ESG reporting mainstreamed and not be hived off as a separate consideration in the hands of a separate 3rd party.</p>

Shetland Islands Council Pension Fund

2023/24 Annual Audit Report

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