



Informing the audit risk assessment for Somerset Pension Fund 2021/22

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between Somerset Pension Fund's external auditors and Somerset Pension Fund's Audit Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit Committee under auditing standards.

Background

Under International Standards on Auditing (UK), (ISA(UK)) auditors have specific responsibilities to communicate with the Audit Committee. ISA(UK) emphasise the importance of two-way communication between the auditor and the Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Audit Committee and supports the Audit Committee in fulfilling its responsibilities in relation to the financial reporting process.

Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Pension Fund's oversight of the following areas:

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Related Parties,
- Going Concern, and
- Accounting Estimates.

Purpose

This report includes a series of questions on each of these areas and the response we have received from Somerset Pension Fund's management. The Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

General Enquiries of Management

Question	Management response
<p>1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2021/22?</p>	<p>Nothing unusual expected in terms of Contribution income or benefits payments. Investment asset valuation will be impacted by current market volatility but are expected to be higher than the prior year level.</p>
<p>2. Have you considered the appropriateness of the accounting policies adopted by Somerset Pension Fund? Have there been any events or transactions that may cause you to change or adopt new accounting policies? If so, what are they?</p>	<p>In light of the annual revisions to the CIPFA Code of Practice and other “best practice” guidance, we continually review our accounting policies and consider how they affect the Council’s and Pension Fund Accounts. Compliance with the CIPFA Code will mean that we use appropriate accounting policies.</p> <p>As we understand it there are no changes to the CIPFA code this year or to the fund’s circumstances and therefore we feel the current polices remain appropriate.</p> <p>There have not been any significant events that have been usual this financial year.</p>
<p>3. Is there any use of financial instruments, including derivatives? If so, please explain</p>	<p>There are specific notes in the accounts covering the use and value of derivatives</p> <p>As part of the transition of our fixed income holdings to Brunel during the 2021-22 financial year we no longer hold any derivatives but there will be reference to the prior year comparators when derivatives were in use.</p>
<p>4. Are you aware of any significant transaction outside the normal course of business? If so, what are they?</p>	<p>Not applicable</p>

General Enquiries of Management

Question	Management response
5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets? If so, what are they?	Not applicable, the level of non-current assets that are also not investment assets is not material.
6. Are you aware of any guarantee contracts? If so, please provide further details	Not Applicable
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements? If so, please provide further details	Not applicable
8. Other than in house solicitors, can you provide details of those solicitors utilised by Somerset Pension Fund during the year. Please indicate where they are working on open litigation or contingencies from prior years?	<p>We have consulted Osborne Clarke on a range of issues to do with employer admission agreements and related matters.</p> <p>As far as we are aware there has been no direct litigation action in the current financial year and no contingencies exist.</p> <p>From time to time our Custodians file on our behalf in class action law suits relating to securities in the US, UK and Europe. This is a passive process by us and we are never the lead litigants.</p>

General Enquiries of Management

Question	Management response
9. Have any of the Somerset Pension Fund's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements? If so, please provide further details	Not Applicable
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	<p>The Somerset Pensions Committee employs an Investment Consultant to sit on the Committee to advise on investment matters. The consultant has been in place for man years.</p> <p>Barnett Waddingham, as the Fund's appointed actuary, is consulted on a range of actuarial matters related to the fund.</p>
11. Have you considered and identified assets for which expected credit loss provisions may be required under IFRS 9, such as debtors (including loans) and investments? If so, please provide further details	We have considered it. We do not believe we have any exposure to credit losses that would require a provision at this time.

Fraud

Matters in relation to fraud

ISA (UK) 240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Audit Committee and management. Management, with the oversight of the Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As Somerset Pension Fund's external auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud,
- process for identifying and responding to risks of fraud, including any identified specific risks,
- communication with the Audit Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from Somerset Pension Fund's management.

Fraud risk assessment

Question	Management response
<p>1. Has Somerset Pension Fund assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Pension Fund's risk management processes link to financial reporting?</p>	<p>We do not believe this to be an issue as no material frauds have been identified during the year. We believe that the risk of unknown material fraud to be low.</p> <p>Internal audit processes are in place and no instances of fraud have been identified in 2021/22.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>Pension payments in relation to Pensioner deaths not being notified to the Pensions Administration Team.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within Somerset Pension Fund as a whole, or within specific departments since 1 April 2021? If so, please provide details</p>	<p>Not Applicable</p>

Fraud risk assessment

Question	Management response
4. As a management team, how do you communicate risk issues (including fraud) to those charged with governance?	Both the Pensions Committee and Pension Board considered the Fund's risk register at every meeting.
5. Have you identified any specific fraud risks? If so, please provide details Do you have any concerns there are areas that are at risk of fraud? Are there particular locations within Somerset Pension Fund where fraud is more likely to occur?	Pensioner deaths being unreported to the Fund, resulting in the continuation of pension payments to the deceased. Yes, see above. Not applicalbe
6. What processes do Somerset Pension Fund have in place to identify and respond to risks of fraud?	The Pensions Administration Team receive regular reports from a national database Informing them of pensioner deaths.

Fraud risk assessment

Question	Management response
<p>7. How do you assess the overall control environment for Somerset Pension Fund, including:</p> <ul style="list-style-type: none"> the existence of internal controls, including segregation of duties; and the process for reviewing the effectiveness the system of internal control? <p>If internal controls are not in place or not effective where are the risk areas and what mitigating actions have been taken?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)? If so, please provide details</p>	<p>Good overall control environment in place with periodical internal audit reviews carried out, based on perceived level of risk.</p> <p>The Pension Fund is a low risk environment due to high level of regulation, segregation of duties, and check and control in place.</p> <p>We do not believe there are areas where controls are not in place.</p>
<p>8. Are there any areas where there is potential for misreporting? If so, please provide details</p>	<p>There is always the potential for misreporting. We believe that the controls in place and detailed reconciliation work that is done that mitigates the risk due to fraud. There is always the potential for genuine human error but this is also mitigated by the controls and reconciliations in place.</p>

Fraud risk assessment

Question	Management response
<p>9. How does Somerset Pension Fund communicate and encourage ethical behaviours and business processes of it's staff and contractors?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud? Have any significant issues been reported? If so, please provide details</p>	<p>The Pension Fund doesn't have any staff. The SCC staff that provide a service to the Fund operate under the normal HR Policies of the Council. All outside organisations contracted by the Fund are bound by strict ethical behaviours contained within their contract?</p> <p>Staff are encouraged to report any concerns about fraud as part of SCC's Whistleblowing Policy. No issues have been reported this year.</p> <p>No issues have been reported in 2021/22.</p>
<p>10. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Investments Manager</p> <p>High level of check and control and segregation of duties.</p>
<p>11. Are you aware of any related party relationships or transactions that could give rise to instances of fraud? If so, please provide details</p> <p>How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>No. All elected members on the Pensions Committee and Board are required on an annual basis to provide details of any related party relationships.</p> <p>SCC staff are bound by the Council's Contract Standing Orders to ensure proper procurement practices are followed at all times.</p>

Fraud risk assessment

Question	Management response
<p>12. What arrangements are in place to report fraud issues and risks to the Audit Committee?</p> <p>How does the Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What has been the outcome of these arrangements so far this year?</p>	<p>Any instances of fraud or the identification of the risk of fraud would be reported to Pensions Board by either Internal Audit or SCC's Audit Committee.</p> <p>No instances of fraud have been reported in 2021/22.</p>
<p>13. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?</p>	<p>Not Applicable</p>
<p>14. Have any reports been made under the Bribery Act? If so, please provide details</p>	<p>Not applicable</p>

Law and regulations

Matters in relation to laws and regulations

ISA (UK) 250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Audit Committee, is responsible for ensuring that Somerset Pension Fund's operations are conducted in accordance with laws and regulations, including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Audit Committee as to whether the body is in compliance with laws and regulations. Where we become aware of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

Impact of laws and regulations

Question	Management response
<p>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does Somerset Pension Fund have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to the Pension Fund's regulatory environment that may have a significant impact on the Pension Fund's financial statements?</p>	<p>SCC staff regularly monitor Pensions Regulations.</p> <p>SCC staff responsible for managing the finances of the Fund regularly check and keep up to date with the LGPS Regulations.</p> <p>No</p>
<p>2. How is the Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>All Pension Fund Policies and Statements are bought to, explained to and approved by the Pensions Board.</p>
<p>3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2021 with an on-going impact on the 2021/22 financial statements? If so, please provide details</p>	<p>Not applicable</p>
<p>4. Are there any actual or potential litigation or claims that would affect the financial statements? If so, please provide details</p>	<p>Not Applicable</p>

Impact of laws and regulations

Question	Management response
5. What arrangements does Somerset Pension Fund have in place to identify, evaluate and account for litigation or claims?	If these occurred they would be reported to Committee by Officers.
6. Have there been any reports from other regulatory bodies, such as HM Revenues and Customs, which indicate non-compliance? If so, please provide details	Not applicable

Related Parties

Matters in relation to Related Parties

Somerset Pension Fund are required to disclose transactions with bodies/individuals that would be classed as related parties. These may include:

- bodies that directly, or indirectly through one or more intermediaries, control, or are controlled by Somerset Pension Fund;
- associates;
- joint ventures;
- a body that has an interest in the authority that gives it significant influence over the Pension Fund;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees of the Pension Fund, or of any body that is a related party of the Pension Fund.

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Pension Fund's perspective but material from a related party viewpoint then the Pension Fund must disclose it.

ISA (UK) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Related Parties

Question	Management response
<p>1. Have there been any changes in the related parties including those disclosed in Somerset Pension Fund's 2020/21 financial statements? If so please summarise:</p> <ul style="list-style-type: none"> • the nature of the relationship between these related parties and Somerset Pension Fund • whether Somerset Pension Fund has entered into or plans to enter into any transactions with these related parties • the type and purpose of these transactions 	Not applicable
<p>2. What controls does Somerset Pension Fund have in place to identify, account for and disclose related party transactions and relationships?</p>	<p>The authorities elected Members are sent an annual questionnaire to identify any material related party transactions, and the findings from the responses are disclosed in the published accounts.</p> <p>The authority reviews existing contractual arrangements to determine whether the authority has significant influence over the other parties due to the considerable proportion of business provided to them by the authority. Any material findings are disclosed in the published accounts.</p>
<p>3. What controls are in place to authorise and approve significant transactions and arrangements with related parties?</p>	<p>Payments to Brunel, Somerset County Council and Peninsula Pensions follow the controls within the AP part of SAP in response to an invoice raised by those bodies and are fully disclosed in the financial statements</p>
<p>4. What controls are in place to authorise and approve significant transactions outside of the normal course of business?</p>	<p>The controls are the same for all transactions. There have been no significant transactions outside the normal course of business during the 2021-22 year.</p>

Going Concern

Matters in relation to Going Concern

The audit approach for going concern is based on the requirements of ISA (UK) 570, as interpreted by Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom (Revised 2020). It also takes into account the National Audit Office's Supplementary Guidance Note (SGN) 01: Going Concern – Auditors' responsibilities for local public bodies.

Practice Note 10 confirms that in many (but not all) public sector bodies, the use of the going concern basis of accounting is not a matter of significant focus of the auditor's time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the body's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist.

For this reason, a straightforward and standardised approach to compliance with ISA (UK) 570 will often be appropriate for public sector bodies. This will be a proportionate approach to going concern based on the body's circumstances and the applicable financial reporting framework. In line with Practice Note 10, the auditor's assessment of going concern should take account of the statutory nature of the body and the fact that the financial reporting framework for local government bodies presume going concern in the event of anticipated continuation of provision of the services provided by the body. Therefore, the public sector auditor applies a 'continued provision of service approach', unless there is clear evidence to the contrary. This would also apply even where those services are planned to transfer to another body, as in such circumstances, the underlying services will continue.

For many public sector bodies, the financial sustainability of the body and the services it provides are more likely to be of significant public interest than the application of the going concern basis of accounting. Financial sustainability is a key component of value for money work and it is through such work that it will be considered.

Going Concern

Question	Management response
<p>1. What processes and controls does management have in place to identify events and / or conditions which may indicate that the statutory services being provided by Somerset Pension Fund will no longer continue?</p>	<p>The only statutory service of the Fund is to provide the benefits to members as they fall due. We have processes in place through treasury management to ensure there is sufficient short term cash resources to make payments as they fall due and then long term plans around solvency. Both are key risks on the risk register of the Fund and managed and reported over time.</p>
<p>2. Are management aware of any factors which may mean for Somerset Pension Fund that either statutory services will no longer be provided or that funding for statutory services will be discontinued? If so, what are they?</p>	<p>Not applicable</p>
<p>3. With regard to the statutory services currently provided by Somerset Pension Fund, does Somerset Pension Fund expect to continue to deliver them for the foreseeable future, or will they be delivered by related public authorities if there are any plans for Somerset Pension Fund to cease to exist?</p>	<p>The payment of benefits is done in conjunction with Peninsula Pensions and this relationship is expected to continue. There are no plans for Somerset Pension Fund to cease</p>
<p>4. Are management satisfied that the financial reporting framework permits Somerset Pension Fund to prepare its financial statements on a going concern basis? Are management satisfied that preparing financial statements on a going concern basis will provide a faithful representation of the items in the financial statements?</p>	<p>We believe the fund has the financial resources to meet its obligations to pay pensions both in the current year and for many years to come. The investment assets represent in the region of 27 to 28 times the annual payment of benefits and the majority could be liquidated in less than a month is necessary. This gives us sufficient assurance that preparing our financial statements on an on-going basis is appropriate.</p>

Accounting estimates

Matters in relation to accounting estimates

ISA (UK) 540 (Revised December 2018) requires auditors to understand and assess a body's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the body's risk management process identifies and addresses risks relating to accounting estimates;
- The body's information system as it relates to accounting estimates;
- The body's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do Audit Committee members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

We would ask the Audit Committee to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting Estimates - General Enquiries of Management

Question	Management response
1. What are the classes of transactions, events and conditions, that are significant to the financial statements that give rise to the need for, or changes in, accounting estimate and related disclosures?	Only those covered in appendix A. There has been no changes in these from the prior financial year
2. How does the Pension Fund's risk management process identify and address risks relating to accounting estimates?	All estimates are made by professional and qualified experts external to management and then scrutinised by management before being used in the financial statements.
3. How does management identify the methods, assumptions or source data, and the need for changes in them, in relation to key accounting estimates?	The methods and assumptions of external experts are scrutinised by management. We do not believe there will be any changes in the methods of external experts for the 2021-22 accounts.
4. How do management review the outcomes of previous accounting estimates?	Estimates in relation to investment asset values are reviewed in the context of moving markets and index moves monthly throughout the year.
5. Were any changes made to the estimation processes in 2021/22 and, if so, what was the reason for these?	Not applicable

Accounting Estimates - General Enquiries of Management

Question	Management response
6. How does management identify the need for and apply specialised skills or knowledge related to accounting estimates?	All estimates are undertaken by professionally accredited and appropriately qualified external experts and then scrutinised by our experienced and professionally qualified officers.
7. How does the Pension Fund determine what control activities are needed for significant accounting estimates, including the controls at any service providers or management experts?	Our external experts are both qualified and subject to regulation by their professional body and/or applicable Government financial regulators. Management believe this provides sufficient assurance of their controls and methods.
8. How does management monitor the operation of control activities related to accounting estimates, including the key controls at any service providers or management experts?	Our external experts are both qualified and subject to regulation by their professional body and/or applicable Government financial regulators. Management believe this provides sufficient assurance of their controls and methods.
9. What is the nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates, including: <ul style="list-style-type: none"> - Management's process for making significant accounting estimates - The methods and models used - The resultant accounting estimates included in the financial statements. 	Although we accept the ultimate responsibility for all content of the financial statements management do not make any material accounting estimates, all estimates are made by external qualified and regulated experts. Management therefore concentrate on scrutinising and challenging those external estimates with the external providers before including them in the financial statements

Accounting Estimates - General Enquiries of Management

Question	Management response
10. Are management aware of any transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement (other than those in Appendix A)? If so, what are they?	Not applicable
11. Why are management satisfied that their arrangements for the accounting estimates, as detailed in Appendix A, are reasonable?	The reliance on external qualified and regulated experts satisfies us that the estimates are reasonable
12. How is the Audit Committee provided with assurance that the arrangements for accounting estimates are adequate ?	The reliance on external qualified and regulated experts, backed up by the assurances of our qualified and experienced officers provides assurance to the audit committee. Further scrutiny of the arrangements is provided by the work of the Pensions Committee and the Pension Board.

Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Valuation of the pension liability	Calculations and estimates are undertaken by a qualified external company of actuaries	All elements of the pension liability are an estimate by their very nature.	Yes	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field. A sensitivity analysis of the value of the liabilities is included in the financial statements	No
Level 3 investments	Reliance on external Fund Managers having assessed the reasonableness of their methods against industry best practice. All Fund managers are subject to regulation by Government Financial regulators	The accounting definition of level three investments means that they must be an estimate as they are not based on observable prices in quoted active market	Yes	A sensitivity analysis of the value assigned to all assets, whether level one, two or three, is included in the financial statements	No
Level 2 investments	All level 2 investments are collective investment funds such as unit trusts or ACS's. These Funds price in accordance with the requirements of the relevant financial regulator (UK or EU)	The accounting definition of level two investments means that they must be an estimate as they are not based on observable prices in quoted active	Yes	A sensitivity analysis of the value assigned to all assets, whether level one, two or three, is included in the financial statements	No



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