

**ORKNEY**  
**ISLANDS COUNCIL**

**ANNUAL REPORT AND  
ACCOUNTS OF THE ORKNEY  
ISLANDS COUNCIL PENSION  
FUND 2015-2016**



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# **MANAGEMENT COMMENTARY BY THE HEAD OF FINANCE, CHIEF EXECUTIVE AND CONVENER OF ORKNEY ISLANDS COUNCIL**

## **Introduction**

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2016.

The Local Government Pension Scheme Amendment (Scotland) Regulations 2014 require the Council, as administering authority for the Fund, to produce a separate statement of accounts for the Pension Fund and incorporate it into an Annual Report.

This Annual Report has been produced to provide Elected Members, Employers, scheme members and other interested parties with information concerning the performance and administration of the fund in financial year 2015-16 and we hope you find its content useful.

To assist in the understanding of the Annual Report and Accounts we would encourage you to make reference to the Management Commentary in the first instance.

We realise that pensions are a highly complicated subject. It is, however, crucially important that members take time to try and understand the scale of benefits that they will receive when they retire - whether this is from the Local Government Pension Scheme itself or through other pension arrangements, such as the State Pension.

## **Overview of Fund Business**

Under the statutory provisions of the Local Government Pension Scheme, Orkney Islands Council is designated as an “Administering Authority” and is required to operate and maintain a pension fund – the Orkney Islands Council Pension Fund (“the Fund”).

The Fund is used to pay pensions, lump sum benefits and other entitlements to scheme members and their dependants. Contributions to the Fund are made by employee members and by participating employers. The Fund also receives income from its investments, which include equities, bonds and multi-pooled assets.

The Fund operates under the terms of the Local Government Pension Scheme, which is a public sector pension arrangement. Scheme membership is made up of active, deferred and pensioner members. To be able to join the scheme, a person must be employed by a relevant employer and not eligible to join another public sector pension scheme. Teachers are not included as they have a separate national pension scheme.

## Review of the Year

### Key Facts And Figures:

**Value of the Fund** at 31 March 2016 was £265.9million (£263.1m at 31 March 2015).

**An Operational and Investment Income Surplus** of £2.8 million was generated on the activities of the fund (compared to £35.4m for the year ended 31 March 2015).

**The Increase in the Value of the Fund** has been achieved mainly through a surplus of contributions receivable (£11.1m) less benefits payable (£6.6m) and management expenses (£1.1m), investment net income (£6.1m) along with a decrease in the market value of investments (£6.3m).

**Performance of the Fund** on a three year rolling average basis has been 7.3% p.a., giving a relative return above benchmark of 1.3%.

**Fund membership** increased by 151 to 3,547.

**Employers contributed** £7.9 million to the Fund (£7.3m to 31 March 2015).

**Employees contributed** £2.2 million (£2.1m to 31 March 2015).

**Pension and other benefits paid out** were £6.1 million (£5.6m to 31 March 2015).

**Net Transfer values paid into the Fund because staff changed employers** were £0.528 million (£0.017m paid out to 31 March 2015).

Over the 12 months to 31 March 2016, the Pension Fund's investments returned a loss of 0.6% which was 0.1% behind the benchmark. The benchmark is based on a local authority pension scheme average performance. Despite the loss to 31 March 2016, the Fund continues to perform ahead of its benchmark over each of the previous 3, 5 and 10 year periods.

The Fund's investments continue to be actively managed by investment managers Baillie Gifford.

The benchmark return of -0.5% generally reflects less favourable market conditions for investors during the year. Within the Fund's portfolio, asset allocation caused returns to be 1.5% worse than benchmark performance, while stock selection improved performance by 1.4%.

The negative asset allocation amount, reflects that the Fund performed less well in terms of its portfolio distribution across asset classes when compared against the average local authority fund performances. The table shown within the Investment strategy section, page 4, details the allocation of the fund within asset class or multi asset pools.

The positive stock selection value of 1.4% reflects that the Fund has outperformed its peers in terms of the specific stocks chosen within different asset classes.

The value of the fund has increased by £2.8m in the financial year and totalled £265.9m at 31 March 2016.

The change in value of the fund over any given period is a combination of the net money flows into or out of the Fund and any gain or loss on the capital value of its investments. During the year income into the fund from dividends and interest was £6.1m (2015: £5.6m). The fund was further enhanced by a surplus of member contributions receivable over pension payments and management expenses of £3.4m (2015: £2.8m surplus). Irrecoverable withholding tax as well as a net capital loss reduced the value of the fund by £0.410m (2015: £0.325m) and £6.314m (2015: £27.3m gain) respectively.

The Accounts are based on the market value of investments at 31 March 2016. This means that they include the profit or loss that has been made, due to the change in the value of investments, over the period from the date of their purchase to 31 March 2016 even though no actual sale has taken place. This notional value is defined as "unrealised" profit or loss. By contrast "realised" profits and losses are those that have arisen from actual sales throughout the year. Of the net capital loss of £6.314m in the year, £9.2m (2015: £17.8m gain) was an unrealised loss and £2.9m (2015: £9.5m) realised profit.

Over the financial year the funding level has dropped to 102% at 31 March 2016 from its value of 106% last financial year end, calculated on an ongoing funding basis. The primary cause of this decline is a decrease in real bond yield, and subsequent discount rate, which places a higher value on the Fund's liabilities. This has been partially offset by a decrease in inflation.

Despite the drop in the funding level calculated at March 2016 from its previous year comparison we are pleased to report that the Fund maintains a position above its 100% funding target, being in surplus by £4m at the financial year end (2015: £15m) according to the actuary's most recent funding update.

## **Investment Trends and Influences**

For the year to 31st March 2016 the value of the Fund fell by 0.6%, performing broadly in line with its benchmark which fell 0.5%.

The following commentary was provided by the Fund's investment managers, Baillie Gifford:-

Major equity markets generally performed positively in the early part of the period, encouraged by a broadly supportive environment of solid corporate profits. Signs of a general improvement in the global economic backdrop and continued low interest rates in many developed countries were also helpful. However, fears over a sharper than anticipated slowdown in Chinese growth as well as concerns about the timing of US interest rate rises and falling commodity prices contributed to the subsequent volatility. Some equity indices delivered small rises for the 12 months as a whole, but many recorded negative returns. Overall, fixed interest markets of developed countries benefited from the uncertainty and posted positive performance for the period.

In the US, the improving economic tone, combined with other factors, such as the return of considerable amounts of cash to shareholders, drove the US stock market to all-time highs in June before it surrendered some of the gains. Regardless, the economic environment continued to strengthen and in December the Federal Reserve announced a 0.25% rise in interest rates, the first increase since 2006.

Conversely, both the European Central Bank and Bank of Japan have increased monetary stimulus with growth and inflation remaining elusive. Market weakness persisted in these regions. Slowing growth, collapsing commodity prices and currency sell-offs all affected investment sentiment in Emerging Markets. Closer to home, much of the UK market's focus is now on the impending referendum on Britain's membership of the European Union.

As ever, some macroeconomic uncertainty remains on the horizon, but we remain cautiously optimistic on the outlook for the global economy. We continue to concentrate on selecting growth businesses with strong prospects over multi-year periods.

### **Impact of EU Referendum**

The impact of the recent decision by the UK to leave the EU, following the EU Referendum vote on 23 June 2016, is likely to become clearer over the coming months.

While much will depend on the precise nature of our future relationship with the EU, this may still mean that some aspects of the UK pension provision will continue to be influenced by the EU.

Initial reactions included an 8.7% slump across the FTSE 100 index upon the financial markets opening on the 24 June 2016, together with the pound hitting a 30 year low against the dollar. While this level of extreme volatility is expected to subside in the near term, the prospects of a reduction in UK GDP growth expectations are likely to weight on both equity markets and interest rates going forward.

Since then the Pension Fund has seen a 13% increase in the value of its investments to 31 August 2016, driven mainly through its exposure to overseas investments which has benefited from exchange rate currency gains as a result of the devaluation in the pound sterling. Against this however, a fall in government bond yields together with a lowering of expected future returns on investments is such that the funding level of the Pension Fund as a whole has fallen from 102% to 96% since 31 March 2016.

## Investment Strategy

The Investment Strategy of the Fund is to invest monies in a prudent and diversified manner, in accordance with the Scheme regulations and in recognition of the risks that accompany investment in various asset classes. The strategy is set out in the Statement of Investment Principles which can be viewed on request

The revised asset allocation and range guidelines that were applied with effect from 1 April 2013 are shown in the Asset Allocation table below together with the actual asset allocation at 31/03/2016.

<b>Asset Class</b>	<b>Asset Allocation at 31/03/2016</b>	<b>Range Guideline</b>	<b>Local Authority Revised Benchmark</b>
	<b>%</b>	<b>%</b>	<b>%</b>
UK Equities	23.3	20-50	22.0
Overseas Equities	46.4	25-55	35.7
Pooled Bonds and Indexed Linked	14.7	10-30	18.1
Global Pooled including UK	0.0	0-35	8.4
Alternative Investments	0.0	0-20	9.6
Cash	3.8	0-10	3.2
Pooled Multi-Asset Funds	11.8	0-35	3.0
<b>Total</b>	<b>100.0</b>		<b>100.0</b>

The bulk of the Fund is held in growth-seeking assets rather than those considered more stable. Direct holdings in equities accounted for 69.7% of the Fund's portfolio as at 31 March 2016.

As a result of its exposure to equities, the relative performance of the Fund against its benchmark can be volatile over the short term. However the fund continues to have a strong funding position together with a net contribution from its dealing with members which allows it to take a long term view across successive investment cycles. The funding position of the Fund is however estimated to have fallen back from 102% as at 31 March 2016 to 96% effective from 31 August 2016 mainly as a result of the impact of the recent EU referendum vote.

The top 10 direct equity holdings within the fund at 31 March 2016 were:-

Company	Market Value of Holding £ m
Baillie Gifford Diversified Growth Fund C G A*	31.2
Baillie Gifford Investment Grade Bond Fund C A**	12.5
Baillie Gifford Active IL Gilt Plus Fund C G A*	9.0
Baillie Gifford Active Gilt Plus Fund C G A*	7.9
Baillie Gifford Emerging Markets Bond Fund C G A*	7.8
Prudential	6.1
Amazon.com	4.6
Royal Carribbean Cruises	4.5
Naspers	4.1
TSMC ADR	3.6

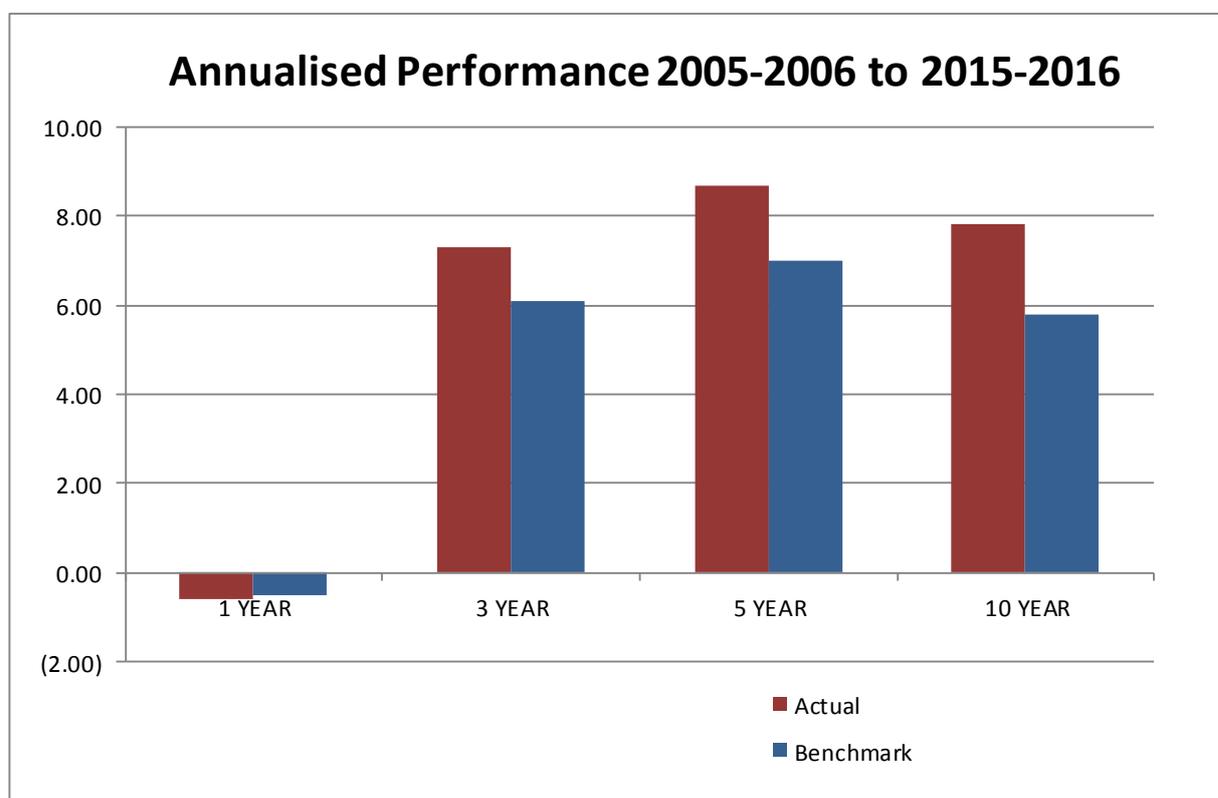
\*Capital Gross Accumulated

\*\* Capital Accumulated

## Investment Performance

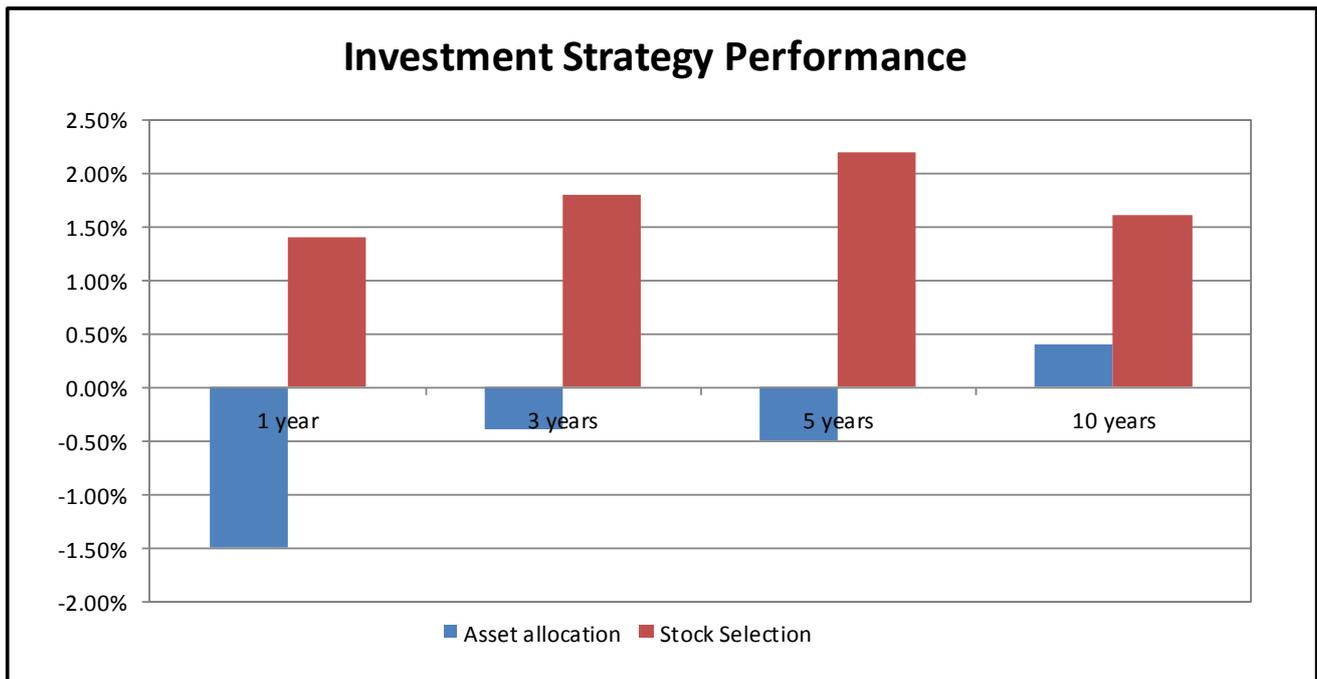
Baillie Gifford's performance target is to outperform the WM Performance Services (WM) Local Authority pension scheme benchmark excluding property (re-balanced quarterly) by 1% p.a. when assessed over rolling 5 year periods, with effect from 1 July 2006. The average performance over the last 5 years of 8.7% remains well ahead of the benchmark of 7.0%. Baillie Gifford's asset allocation and stock selection is reviewed on a regular basis by the WM Company.

The following graph summarises investment performance on an annualised basis over 1, 3, 5 and 10 year periods:-



Despite the Fund returning a loss of 0.3% over the 12 months, the 3, 5 and 10 year figures demonstrate a consistent level of outperformance for the Fund which remains ahead of target.

The following graph demonstrates the performance of the Fund’s investment manager in respect of asset allocation and stock selection against the Local Authority benchmark.



From this it can be seen that while Asset Allocation has detracted from the performance of the Fund, and most notably in the past 12 months, this has been more than offset by the active stock selection activities of the investment manager across all other periods.

## Structure of Administration

### Staffing

Membership and Benefits Administration of the Scheme is carried out in house and undertaken by the Pensions team within Orkney Islands Council’s Chief Executive’s Service. The Pensions team is responsible for the maintenance of members’ records using data supplied by all employers in the Fund.

In addition to maintaining members’ records, the Pensions team also provide frontline services to Fund members. In addition to answering calls, e-mails and drop in meetings at the request of employees the Pension team deliver induction courses. Pre-retirement surgeries are arranged for members by the Human Resources and Performance team within Corporate Services.

During the past year, the size of the Pensions team was increased from 1.5 to 3.0 full time equivalents, including 0.5 temporary, in recognition of the additional workload associated with the implementation of the new Altair system combined with the changes to the Scheme’s regulations including auto enrolment and CARE. The Pensions team now consists of one full time Pensions Manager, a Senior Assistant and an Assistant.

The above resources are supplemented by shared resources within the Chief Executive’s Service which provides additional governance, payments investment and accounting expertise.

### Systems

A manual record is kept for everyone who has a pension entitlement from the Fund and records retirements, deaths, transfers and refunds in the Local Government Pension Scheme.

Manual records are currently being transferred to the Heywood's Pensions Administration system known as Altair.

The Council's Payroll system, NorthgateArinso is used to pay pensioner benefits. The Pensions team have viewing access to the payroll system, however amendments are made via a formal requests process to the Payroll team. Both the Pensions and Payroll teams are within Chief Executive's Service.

## Administration Performance

Orkney Islands Council as administering authority is committed to providing a high quality pension service to both members and employers and to ensure members receive their correct pension benefit entitlement.

Performance during financial year 2015-16 against the key service standards of the Pension Fund as set by the Council was as follows:

Category	Performance Standard – No of Working Days	Number of records processed within standard	Number of records processed Outwith standard	Percentage of records processed within standard	Prior Year Performance
Pension estimates	10	17	31	35.4%	51.9%
Retirement	3	48	2	96.0%	91.9%
Transfers In	10	20	5	80.0%	52.0%
Transfers Out	10	5	4	55.6%	84.6%
Refunds	3	24	3	88.9%	89.3%

## Fund Update

Membership details are shown below along with a short description for each membership status:

Member Status	2014-15	2015-16
Contributing members	1,781	1,888
Pensioners	758	779
Deferred members	857	880
<b>Total</b>	<b>3,396</b>	<b>3,547</b>

### Contributing Member

Someone who is currently employed by a scheduled or admitted body and is making contributions from pay to the Pension Scheme. Such a person is sometimes referred to as an "active" member.

<b>Deferred Member</b>	Someone who was once a contributing member and who has chosen to leave his or her accumulated contributions in the Fund to benefit from a pension in due course.
<b>Pensioner/Dependant Member</b>	Someone who is receiving benefits from the Fund either as a former contributor or as a dependent of a former contributor who has deceased.

### **Employer Bodies**

The Fund invested and administered pensions on behalf of 9 current and former employers during 2015-16. These include scheduled bodies, brought into the Fund by legislation, and admitted bodies, which chose to join the Fund. The detailed listing of employers and their membership numbers is contained in Note 22 of the Annual Report and Accounts for the Fund (page 35).

### **Pension Increases**

Pensions which are in payment and deferment are increased each April in accordance with the Pension (Increase) Act 1971. Since April 2011, this increase has been linked to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI).

### **Actuarial Valuation**

Annex 2 contains the formal Actuarial Statement for 2015-16 which is prepared in line with the International Accounting Standard (IAS) 26 and supports the preparation of the Financial Statements for the Pension Fund.

The last triennial valuation, as at the 31 March 2014, revealed that the Fund's assets at 31 March 2014 were valued at £227m, and were sufficient to meet 114.4% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. This compared with 106.3% at the previous March 2011 valuation. The resulting surplus at the 2014 valuation was £29m.

The improvement in the funding position reflected the positive cash flow from member contributions over benefits and good investment performance of the Fund since the previous valuation. Investment returns for the three years to 31 March 2014 were significantly better than anticipated. As a result of the valuation process, the Fund's actuary (Hymans Robertson) calculated the contribution rate at 15.2% (2011: 16.5%). However, taking into account recent market conditions, the actuary recommended that the current contribution rate of 21.4% be maintained during 2015/16 with a minimum contribution rate of 19.8% in 2016/17 and 19.2% during 2017/18.

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement.

The most recent funding update produced at 31 March 2016 showed that the funding surplus has decreased since the last full valuation. Falling real bond yields were partially offset by strong asset returns and have resulted in a reduction from last year's funding level of 106%, to 102% at 31 March 2016.

## Main Risks and Uncertainties facing the Fund

Awareness of risk and risk mitigation is a key facet of the Fund's strategic and operational activities. Whilst it is not possible to eliminate risk entirely, the Fund has taken steps to evaluate risk and put strategies and controls in place to minimise its adverse effects.

The Fund has its own risk register, which details some 33 risks faced by the fund and can be viewed at [www.orkney.gov.uk](http://www.orkney.gov.uk). The risk register is reviewed annually by the Pension Fund Sub-Committee and Pension Board.

Principal risks, and the way in which they are managed, are as follows:

**Financial Mismatch**, the risk that the Fund's assets fail to grow in line with the cost of meeting its liabilities. The Sub-committee measures and manages financial mismatch in several ways. It has set a strategic asset allocation benchmark for the Fund and assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns. It also assesses risk relative to liabilities by monitoring benchmark returns relative to liabilities. The Sub-committee keeps under review demographic assumptions which could impact on the cost of benefits. These assumptions are considered formally in the triennial valuation and reviewed annually within funding update reports (Navigator) produced by the Fund's actuary, Hymans Robertson.

**Systemic Risk**, the risk of an interlinked and simultaneous failure of several asset classes and/or investment managers. The Pensions Sub-committee seeks to manage systemic risk by the appointment of investment managers. The Pensions Sub-committee regularly reviews total asset values within asset class.

**Liquidity Risk**, the risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets. This is controlled by the regular estimation of cash flow to ensure that sufficient cash balances are available. By holding the majority of its assets in liquid assets such as equities and bonds unexpected cash flow requirements can be met by the realisation of assets. Liquidity risk is also moderated by the Fund continuing to have a surplus of contributions receivable over pensions payable.

**Custody Risk**, the risk of losing rights to Fund assets when they are held in custody or being traded. The Pensions Sub-committee manages custody risk by the monitoring of custodian activities. The Fund has appointed Bank of New York Mellon's London branch as its Custodian.

**Transition Risk**, the risk of incurring unexpected costs or losses when assets are transferred between asset classes. When carrying out significant transitions the Pensions Sub-committee will take professional advice and consider the appointment of specialist transition managers.

## Future Developments

### Career Average Revalued Earnings Scheme (CARE) – LGPS 2015

A number of important changes have been made to the LGPS from 1 April 2015. The changes, which have been agreed between the Trade Unions, COSLA and the Scottish Government, ensure that the Scheme complies with the terms of the Public Pensions Act 2013.

From 1 April 2015 the Pension Scheme moved away from a final salary to a career average revalued earnings scheme (CARE).

The main changes of this scheme are:

- A move towards benefits being worked out using career average revalued earnings rather than final salary;
- Pensions being built up at a rate of 1/49th of annual pensionable pay;

- Member's normal retirement age being linked to their own State Pension Age. Members may still be able to retire from age 60 but a reduction for early payment may apply;
- Protection of benefits for members aged 55 and over at 1 April 2012 who will be guaranteed that their benefits will not be less than they would have been if the 2015 scheme had never been introduced; and
- Benefits built up before April 2015 will continue to be calculated using actual final pensionable pay at date of leaving.

### **Development of the Pension Fund Sub-committee and Pensions Board**

On 17 February 2015, Council as Administering Authority agreed that the Investments Sub-committee continue in existence to fulfil its role in relation to non-pension fund, treasury and investment matters and that a Pension Fund Sub-committee, comprising the same membership as the Investment Sub-committee, be established to fulfil the role of the Scheme Manager for the purposes of the Public Services Pensions Act 2013.

The Policy and Resources Committee also agreed to the establishment of a Pensions Board, membership of which consists of four trade union representatives and four employer representatives. In accordance with the respective terms of reference, which were also agreed at the first meeting of the Pension Fund Sub-committee and Pension Board, the group have since met concurrently on four occasions during 2015-16.

Training activity for the members of the Pension Fund Sub-Committee, Pension Board and Investment Sub-committee was undertaken during the financial year 2015-16 to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively including an induction training event held in April 2015.

### **Acknowledgement**

We would like to take this opportunity to thank our colleagues in Chief Executive's Services and the members of: the Pension Fund Sub-Committee and the Pensions Board for their help and co-operation in managing the financial affairs of the Pension Fund.

**Gareth Waterson, BAcc, CA**  
Head of Finance  
19 September 2016

**Councillor Steven Heddle**  
Council Convener  
19 September 2016

**Alistair Buchan**  
Chief Executive  
19 September 2016

## **STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS**

### **Responsibilities of the Orkney Islands Council as Administering Authority**

The Council is required to:

- Make arrangements for the proper administration of the financial affairs of the Orkney Islands Council Pension Fund (the Fund) and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Head of Finance.
- Manage the affairs of the Fund to secure economic, efficient and effective use of resources and safeguard its assets.
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (Section 12 of the Local Government in Scotland Act 2003).
- Approve the Annual Accounts for signature.

I confirm that these Annual Accounts were approved for signature at a meeting of the Pension Fund Sub-Committee on 19 September 2016.

### **Signed on behalf of Orkney Islands Council**

#### **Councillor Steven Heddle**

Council Convenor  
19 September 2016

### **The Head of Finance's responsibilities**

The Head of Finance is responsible for the preparation of the Annual Accounts in accordance with proper practices as required by legislation and as set out in the CIPFA/LASAAC Code on Local Authority Accounting in the United Kingdom (the Code).

In preparing these Annual Accounts, the Head of Finance has:

- Selected suitable accounting policies and then applied them consistently.
- Made judgements and estimates that were reasonable and prudent.
- Complied with legislation.
- Complied with the Code (in so far as it is compatible with legislation).

The Head of Finance has also:

- Kept adequate accounting records which were up to date.
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that the annual accounts give a true and fair view of the financial position of the Orkney Islands Council Pension Fund as at 31 March 2016, and of its transactions for the year ended 31 March 2016.

**Gareth Waterson, BAcc, CA**

Head of Finance

19 September 2016

## **REMUNERATION REPORT**

The Pension Fund does not directly employ any staff. We have therefore not included a remuneration report within the Annual Report.

All staff are employed by Orkney Islands Council, and their costs reimbursed by the Pension Fund.

The Councillors, who are members of the Pension Fund Sub-Committee and Pension Board are also remunerated by Orkney Islands Council.

Details of Councillor and Senior Employee remuneration can be found in the accounts of Orkney Islands Council on the Council's website <http://www.orkney.gov.uk/>

# ANNUAL GOVERNANCE STATEMENT

## Governance Arrangements

1. This statement is given in respect of the Accounts of Orkney Islands Council Pension Fund. As Chief Executive and Convener for the Council as Administering Authority, we acknowledge our responsibility for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all governance matters, keeping proper administrative and financial records and accounts and maintaining an effective system of arrangements for governance control.
2. The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees, supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:
  - Comprehensive accounting systems that record income and expenditure for both member and investment activities,
  - Regular reviews of investment reports that measure investment returns against agreed benchmarks,
  - Regular reviews of investment manager reports that measure performance against agreed targets, and
  - Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.
3. The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
4. The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and its own independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

## 5. Administering Authority

- 5.1 Orkney Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Orkney Islands Council geographic area.
- 5.2 The Council has delegated the management of the investment of the Pension Fund to the Pension Fund Sub-Committee.
- 5.3 The Council has established a Pension Board which is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.

## 6. Regulatory Framework

- 6.1 The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with guidance and regulations issued by the SPPA.

- 6.2 The Orkney Islands Council scheme is open to all employees of scheduled bodies except for those whose employment entitles them to belong to another statutory pension scheme (e.g. Teachers). Employees of admitted bodies can join the scheme subject to those bodies meeting the statutory requirements and on such terms and conditions as the Council (as Administering Authority) may require. A list of scheduled and admitted bodies is attached in Annex 1.
- 6.3 The Pension Fund Sub-committee (the Sub-committee) is a formal sub-committee of Orkney Islands Council's Policy and Resources Committee. The Scheme of Administration for the Council refers to the Pension Fund Sub-committee all matters relating to the management of investments of the Council's Pension Fund.
- 6.4 Financial affairs are conducted in compliance with the Council's Financial Regulations which were formally adopted by the Pension Fund in 2011.
- 6.5 Funds are invested in compliance with the Fund's Statement of Investment Principles.

## **7. Pension Fund Sub-committee and Pensions Board**

- 7.1 The members of the Pensions Sub-committee together with the Pensions Board act as quasi-trustees and oversee the management of the Orkney Islands Council Pension Fund (the Fund).
- 7.2 Their overriding duty is to ensure the best possible outcomes for the Fund, its participating employers and scheme members.
- 7.3 The members' knowledge is supplemented by professional advice from officers of the Council, professional advisers and external experts.
- 7.4 The Sub-committee is comprised of the members of the Investments Sub-committee which itself is formed from seven members of the Council:
- Convener (Chair of Policy and Resources Committee)
  - Vice Convener (Vice Chair of Policy and Resources Committee)
  - Five other elected members of the Council
- 7.5 The Independent Investment Consultant, the Director of Corporate Services, Head of Finance, Corporate Finance Senior Manager and Solicitor also attend the Sub-committee meetings as advisers.
- 7.6 The Sub-committee meets at least quarterly. Additional meetings are called as appropriate.
- 7.7 The Sub-committee papers and minutes are publicly available on the Council's website, unless they have been considered as private business in terms of Schedule 7A to the Local Government (Scotland) Act 1973. Minutes of the Sub-Committee are presented to the Policy and Resources Committee of the Council.
- 7.8 Membership of the Pension Board consists of equal numbers of trade union representatives and employer representatives, drawn from Orkney Islands Council and scheduled or admitted bodies in membership of the Pension Fund. Pension Board representatives may not also participate in or act as members of the Pension Fund sub-committee or the Monitoring and Audit Committee. Local Authority employer representatives will normally be Elected Members of the Council.
- 7.9 The Pension Board meets at least quarterly. A majority of either side may requisition a special meeting of the Pension Board in exceptional circumstances.

- 7.10 While the statutory roles and function of the Pension Fund Sub-committee and Pension Board are separate, the normal practice is that both bodies meet at the same time to consider the same agenda, with the Chair of the Pension Committee chairing the concurrent meeting. The Council's Standing Orders apply at concurrent meetings. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.
- 7.11 If the Pension Fund Sub-committee and Pension Board cannot reach joint agreement on any matter the process for resolving any differences between the two bodies is as follows. In the first instance, if at least half of the members of the Pension Board agree, then the Pension Board can refer back a decision of the Pension Fund Sub-committee for further consideration if any of the defined grounds are met. Whilst this process is undertaken the decision of the Pension Fund Sub-committee is still competent.
- 7.12 If there is no agreement after the matter has been referred back to the Pension Fund Sub-committee, the decision of the Pension Fund Sub-committee stands and the difference in view between the Pension Board and the Pension Fund Sub-Committee will be published in the form of a joint secretarial report on the Pension Fund website and included in the Pension Fund annual report.
- 7.13 The Scottish LGPS Scheme Advisory Board may also consider and take a view on the matter and, if considered appropriate, provide advice to the Scheme Manager or the Pension Board in relation to the matter.

## **8 Administration and Financial Management of the Fund**

- 8.1 The Council's Head of Finance is the Officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.
- 8.2 The Head of Finance is responsible for:
- the financial accounting of the Fund,
  - the preparation of the Pension Fund Annual Report, and
  - being the principal advisor on investment management to the Council in its capacity as Trustee to the Fund and as the Fund's Administering Authority.
- 8.3 The day-to-day management of the investment activities of the Fund is managed by the Corporate Finance Service within the Chief Executive's Service.
- 8.4 The pension benefits policy oversight and day-to-day administration for the Fund is managed by the Pensions Team within the Service area of Finance which in turn is within Chief Executive's Service.
- 8.5 The annual financial statement of the Fund is subject to external audit. The auditors are appointed by Audit Scotland, as part of the process to ensure that public funds are properly safeguarded and accounted for.

## **9 Professional Advisers and External Service Providers**

- 9.1 Hymans Robertson is appointed to act as Actuary to the Fund. The services provided include advice on investment strategy, funding level and actuarial valuations.
- 9.2 The Fund has appointed Baillie Gifford as investment manager who have responsibility for the selection, retention and realisation of individual investments. Where appropriate, they also implement the Sub-Committee's policy in relation to corporate socially responsible investment and corporate governance.

- 9.3 Bank of New York Mellon is the global custodian for the Fund and is responsible for the safekeeping of the assets including transaction processing and making tax claims.
- 9.4 WM Performance Services provides independent performance services for the Fund. They had responsibility for measuring and reporting on the performance of the Fund during the year.

## **10. Internal and External Controls and Review**

- 10.1 The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees. It is supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:
- Comprehensive accounting systems that record income and expenditure for both member and investment activities,
  - Regular reviews of investment reports that measure investment returns against agreed benchmarks,
  - Regular reviews of investment manager reports that measure performance against agreed targets, and
  - Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.
- 10.2 The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
- 10.3 The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and the Orkney Islands Council's independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.
- 10.4 During 2015-16 in response to risks highlighted in Audit Scotland's annual audit plan, staffing levels within the Pensions Administration Team were formally reviewed in recognition of additional demands being placed on the team associated with the implementation of the changes in the scheme regulations, including auto enrolment and CARE. The outcome of this review was to increase staffing levels in the Pensions Administration Team from 1.5FTE to 3FTE, which will drop down to 2.5FTE in May 2018.
- 10.5 The Head of Finance (Section 95 officer) for the council as Administering Authority is responsible for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.
- 10.6 The Chief Internal Auditor (CIA) reports to the Executive Director of Corporate Services and the Monitoring and Audit Committee and is in regular contact with the Head of Finance and Monitoring Officer. The CIA provides an independent and objective annual assurance statement on the effectiveness of internal control, risk management and governance based on the delivery of an approved plan of systematic and continuous internal audit review of the Council's arrangements. For the year ended 31 March 2016, Internal Audit did not carry out any specific work on the Pension Fund. However, given the structural size of Orkney Islands Council, there are common controls over council systems and pension systems. Internal audit's work on council systems provides

management assurance that pension fund operations and transactions are appropriately controlled.

## **11. Risk Management**

11.1 The Fund's Risk Register was reviewed and updated at the concurrent meeting on 18 February 2016 of the Pension Fund Sub-committee together with the Pensions Board.

11.2 Risk awareness is embedded into the investment performance management process.

## **12. Access to Information**

12.1 Sub-committee papers and minutes are available via the Council website [www.orkney.gov.uk](http://www.orkney.gov.uk).

12.2 The Fund's Annual Report and Accounts is available via the Council's website [www.orkney.gov.uk](http://www.orkney.gov.uk).

## **13. Compliance with Best Practice**

13.1 The Local Government Pension Scheme (Scotland) Regulations 2014 require Administering Authorities to measure their governance arrangements set out against standards set by Scottish Ministers. These standards are established via a number of best practice principles. The Governance Compliance Statement details the Fund's status against these standards.

13.2 In July 2012 the Council adopted its local Code of Corporate Governance which is fully consistent with the principles and requirements of the CIPFA / SOLACE publication entitled, "Delivering Good Governance in Local Government: Framework".

## **14. Opinion**

14.1 Our review of the effectiveness of the system of internal financial control is informed by:

- a. The work of Internal Audit and the professional accountancy staff within the Council;
- b. The External Auditor's reports,
- c. The Head of Finance (Section 95 Officer), whose duties include putting in place the arrangements for the proper administration of financial affairs of the Pension Fund.

14.2 We have noted that implementing high priority recommendations made by External Audit would further enhance the internal financial control environment to manage financial risks. A Risk Register, Procedural Standing Orders and a scheme of delegation have been formally adopted by the Pensions Board.

14.3 It is our opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal financial control systems during the year ended 31 March 2016.

**Councillor Steven Heddle**  
Council Convener  
19 September 2016

**Alistair Buchan**  
Chief Executive  
19 September 2016

## GOVERNANCE COMPLIANCE STATEMENT

The Regulations that govern the management of LGPS funds in Scotland require that a Governance Compliance Statement is published. The following compliance statement sets out the extent to which the Orkney Islands Council Pension Fund governance arrangements comply with best practice.

Principle		Full Compliance	Comments
<b>Structure</b>	The management of the Administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council.	Yes	On 17 <sup>th</sup> February 2015, the Policy and Resources Committee (PRC) established a Pension Fund Sub Committee (PSC) and delegated to it the power to discharge all functions and responsibilities relating to the Council's role as administering authority for Orkney Islands Council Pension Fund (the Pension fund). The PSC is the main committee in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Services Act 2013. The PRC further agreed to establish a Pensions Board (PB) as a secondary committee to underpin the work of the main committee.
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes	There are no admitted bodies or deferred members represented on the PRC or PSC.  Orkney Ferries Limited an admitted body currently has a representative on the PB.  The existing membership of the PSC includes both active and pensioner members of the Orkney Island Council Pension Fund.
	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The agreed terms of reference for operation of the PSC include the requirement to produce a formal minute of all Forum meetings. The PSC sit at the same time as the PB allowing them to communicate with each other on the day they sit.
	That where a secondary committee or panel has been established; at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	The PSC and PB sit at the same place and time to assist the formation of a consensus. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.

Principle	Full Compliance	Comments
		Membership of the PSC will include all 7 elected members of the ISC.
<b>Representation</b>	Yes	<p>In accordance with the terms of reference for the operation of the PB, membership comprises 8 members; four trade union representatives and four employer representatives.</p> <p>Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters.</p>
	Yes	In accordance with the terms of reference, all members of the PB and PS C are treated equally. The two bodies sit at the same time to facilitate equal opportunity.
<b>Selection and Role of Lay Members</b>	Yes	At the inaugural meeting of the Pensions Sub Committee and Pensions Board, held concurrently on 24 April 2015, respective Terms of Reference were duly approved for each body. In addition an induction programme has been provided to members.
	Yes	The declaration of Member's interests is a standard item on the agenda of the PSC and PB.
<b>Voting</b>	Yes	Full voting rights are given to all members of the PSC.
		The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.

Principle	Full Compliance	Comments
<b>Training/ Facility Time/ Expenses</b>	Yes	The CIPFA Code of Practice for Public Sector Pensions Finance Knowledge and Skills, together with a Knowledge and Skills Framework to support the Code has been adopted as the basis for training and development of members and officers involved in Pension Fund financial matters. CIPFA Framework Members' training is funded from the Council's Pension Fund.
	Yes	All members are treated equally under the training policy.
	Yes	The Administering Authority of the newly formed Pension Fund Sub-committee and Pension Board has to date considered the training requirements of committee members collectively and provided training on that basis. Further consideration will be given to the development of training plans in 2016. A log has been established of all training provided to members and this is monitored and reported as appropriate.
<b>Meeting Frequency</b>	Yes	The PSC and PB are scheduled to meet at least four times a year.
	Yes	The PSC and PB are scheduled to meet at least four times a year.
	Yes	On 17 February 2015, the PSC agreed to establish a Pensions Board (PB), with Union, and admitted body membership.
<b>Access</b>	Yes	All members are treated equally.

Principle		Full Compliance	Comments
	secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.		
<b>Scope</b>	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The PSC deal with all matters relating to both the administration and investment of the Pension Fund. The PSC is formed from members of the Investments Sub Committee of the council.
<b>Publicity</b>	That administering authorities have published details of their governance arrangements in such a way that stakeholders, can express an interest in wanting to be part of those arrangements.	Yes	The Orkney Islands Council Pension Fund governance documents are available upon request. The Council as administering authority communicates regularly with employers and scheme members.

**Councillor Steven Heddle**  
Council Convener  
19 September 2016

**Alistair Buchan**  
Chief Executive  
19 September 2016

**ANNUAL ACCOUNTS 2015-16****Pension Fund Account**

The Pension Fund Account sets out all income and expenditure of the Pension Fund.

2014-15 £'000		2015-16 £'000	Notes
	<b>Dealings with members, employers and others directly involved in the scheme</b>		
9,373	Contributions Receivable	10,052	5
288	Transfers In	998	6
9,661		11,050	
(5,597)	Benefits Payable	(6,105)	5
(305)	Payments to and on account of leavers	(470)	7
(923)	Management Costs	(1,095)	15
(6,825)		(7,670)	
<b>2,836</b>	<b>Net additions from dealings with members</b>	<b>3,380</b>	
	<b>Return on Investments</b>		
5,595	Investment Income	6,091	8
27,288	Profits/(losses) on disposal of investments and changes in the market value of investments	(6,271)	9,12
(325)	Taxes on Income	(384)	
<b>32,558</b>	<b>Net Return/(Loss) on Investments</b>	<b>(564)</b>	
<b>35,394</b>	<b>Net increase in the net assets available for benefits during the year</b>	<b>2,816</b>	
227,739	Opening Net Assets of the Scheme	263,133	
<b>263,133</b>	<b>Closing Net Assets of the Scheme</b>	<b>265,949</b>	

## Net Assets Statement as at 31 March 2016

The Net Assets Statement sets out the value, as at the statement date, of all assets and current liabilities of the Fund. The net assets of the Fund (assets less current liabilities) represent the funds available to provide for pension benefits as at 31 March 2016.

31 March 2015 £'000		31 March 2016 £'000	Notes
	<b>Investment Assets</b>		
189,215	Equities	182,369	
	<b>Managed Funds</b>		
69,586	Pooled Investment Vehicles	72,521	
2,716	Cash Equivalents	10,040	
261,517		264,930	10
	<b>Current Assets</b>		
82	Cash Balances	75	
55	Contributions due from Employers	70	
1,696	Current Debtors	1,396	
1,833		1,541	13
	<b>Current Liabilities</b>		
(217)	Current Creditors	(522)	14
1,616	<b>Net Current Assets/(Liabilities)</b>	1,019	
263,133	<b>Net Assets of the Scheme available to fund benefits at the year end</b>	265,949	

The Fund Account and Net Assets Statement do not show any liability to pay pensions or other benefits in the future. The liability to pay pensions is detailed in Note 4 Actuarial Present Value of Promised Retirement Benefits.

The unaudited accounts were issued on 10 June 2016 and the audited accounts were authorised for issue on 19 September 2016.

**Gareth Waterson, BAcc, CA**  
Head of Finance  
19 September 2016

## Notes to the Annual Accounts

### 1. The Local Government Pension Scheme

The Local Government Pension Scheme is a funded defined benefit scheme, established under the Superannuation Act 1972, with pensioners receiving index-linked pensions. It is administered by Orkney Islands Council in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) and was contracted out of the State Second Pension until the 6 April 2016 when the new State Pension was introduced. The Pension Fund is subject to a triennial valuation by an independent, qualified Actuary, whose report indicates the required future employer's contributions.

### 2. Basis of Preparation of the Financial Statements

Local authorities have a duty under section 12 of the Local Government in Scotland Act 2003 to observe proper accounting practices.

The accounts for the Fund have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2015-16 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

### 3. Statement of Accounting Policies

A summary of the more important accounting policies has been set out below:

#### 3.1 Basis of Preparation

The accounts have been prepared on an accruals basis and do not take account of liabilities to pay pensions and other benefits after the year end. However, the actuarial position does account for such obligations. This is disclosed in Note 4 of the accounts and should be read in conjunction with the Actuarial Statement (Annex 2). The going concern concept assumes that the Pension Fund will continue in existence for the foreseeable future.

#### 3.2 Transfers to and from other schemes

Transfer values represent the amounts receivable and payable during the year for members who have either joined or left the fund during the financial year and are calculated in accordance with the LGPS Regulations.

Individual transfers in/out are accounted for when receivable/payable, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receivables basis and are included in Transfers in.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

#### 3.3 Financial Instruments

##### Investments

Investments are included at market values, which are assessed as follows:-

3.3.1 UK quoted securities are valued at bid market prices at close of business on the last working day of the financial year.

3.3.2 Overseas securities are valued at bid market prices from the relevant overseas stock exchanges converted at closing rates of exchange on the last day of the financial year.

3.3.3 Pooled investments, which comprise the fund manager's unit trusts and open ended investment companies, are valued at bid market prices on the last working day of the financial year as supplied by the fund manager.

Since Investments are all held for trading, disclosure in the accounts is at fair value through profit and loss. Fair values are derived from unadjusted quoted prices in active markets.

### **3.4 Recognition of Income and Expenditure**

Activity is accounted for in the year in which it takes place, not simply when cash payments are made or received. In particular:

3.4.1 Expenses in relation to services received (including services provided by Orkney Islands Council) are recorded as expenditure when the services are received rather than when payments are made.

3.4.2 Dividend income is recognised when the right to receive payment is established.

3.4.3 Where income and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Net Assets Statement.

### **3.5 Cash and Cash Equivalents**

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are investments that mature in less than three months from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

### **3.6 Administrative Overheads**

The Pensions Section of Orkney Islands Council is responsible for administering the pension fund. The section receives an allocation of the overheads of the council which is based on its direct cost and the amount of central services consumed.

### **3.7 Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors**

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Fund's financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

This year, there was a change of accounting policy 3.2, Transfers to and from other schemes. Formerly they were accounted for when transfer values were received and paid. From this year, they are accounted for at the time that they become

receivable or payable. In 2014/15, there were transfers in that amounted to £26,000 which would have been included if the change of policy had applied. As the amount is not material, a retrospective adjustment to 2014/15 has not been made.

### **3.8 Events after the Balance Sheet**

Events after the net assets statement date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Statement of Accounts is authorised for issue. Two types of events can be identified:

- 3.8.1 those that provide evidence of conditions that existed at the end of the reporting period – the Statement of Accounts is adjusted to reflect such events.
- 3.8.2 those that are indicative of conditions that arose after the reporting period – the Statement of Accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

The draft annual accounts were signed by the Head of Finance on 29 June 2016. Events taking place after this date have not been reflected in the financial statements. Material events between the balance sheet date and the date of signing have been considered and where necessary reflected in the financial statements.

### **3.9 Investment Income**

Income from fixed interest, index linked securities and other interest receivable is taken into account on an accruals basis. Income from all other marketable securities is taken into account on the date when stocks are quoted ex-dividend.

### **3.10 Foreign Currency**

Income and expenditure arising from transactions denominated in a foreign currency are translated into £ sterling at the exchange rate in operation on the date on which the transaction occurred. Where the transaction is to be settled at a contracted rate, that rate is used.

### **3.11 Investment Management Expenses**

Investment management expenses consist of direct charges in line with management agreements, management charges levied on pooled funds and administrative charges.

### **3.12 Acquisition Cost**

Any acquisition costs of investments are included in the book cost of the investment.

### **3.13 Critical Judgements in Applying Accounting Policies**

#### **Pension Fund liability**

The Pension Fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with International Accounting Standard IAS 19. The judgements which have the greatest impact on pension fund liabilities are those around the discount rate, the inflation rate and the life expectancy of members.

### 3.14 Assumptions made about the future and other major sources of estimation and uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Pension Fund about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because such factors cannot be determined with certainty, actual results could be materially different from the assumptions and estimate. The items in the financial statements at 31 March 2016 for which there is a significant risk of material adjustment in the forthcoming financial year is as follows:-

Item	Uncertainties
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

Change in assumptions at year ended 31 March 2016	Approximate % increase to Employer Liability	Approximate monetary amount £m
0.5% decrease in Real Discount Rate	11%	32
1 year increase in member life expectancy	3%	8
0.5% increase in the Salary Increase Rate	4%	12
0.5% increase in the Pension Increase Rate	7%	19

### 3.15 Accounting Standards that were issued but not yet adopted

There is a requirement in the Code to disclose the expected impact where a new accounting standard has been issued between 1 January and the year-end but not yet adopted. The standards introduced by next year's Code that are relevant to pension funds include:

- Annual improvements to IFRS 2010 – 2012 cycle
- Annual improvements to IFRS 2012 – 2014 cycle.
- Amendment to IAS 1 Presentation of Financial Statements (Disclosure Initiative - the changes to the format of the Fund Account and the Net Assets Statement)

These are not expected to have an impact on the Fund.

## 4. Actuarial Present Value of Promised Retirement Benefits

The Fund's actuary undertakes a valuation of the Fund's liabilities to pay future retirement benefits. This is calculated in line with the IAS 19 every year using the same base data as the triennial funding valuation, rolled forward to the current financial year and taking into account changes in membership numbers and updated assumptions.

In order to assess the value of liabilities on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Annex 2).

The actuarial present value of promised retirement benefits at 31 March 2016 was £281m (2015: £296m).

This figure is used for statutory accounting purposes by Orkney Islands Council Pension Fund and complies with the requirements of IAS 26 Accounting and Reporting by Retirement Benefit Plans. The IAS 26 valuation is not used for calculations undertaken for funding purposes and setting contributions payable to the Fund and has no validity in other circumstances.

**Financial Assumptions**

Year ended	31-Mar-16 % p.a.	31-Mar-15 % p.a.
Inflation/Pensions Increase Rate	2.2%	2.4%
Salary Increase Rate	4.2%	4.3%
Discount Rate	3.5%	3.2%

Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 26.

**Longevity Assumptions**

	Males	Females
Current Pensioners	22.4 years	23.8 years
Future Pensioners*	25.0 years	27.0 years

\*Future pensioners are assumed to be currently aged 45

**Commutation assumption**

An allowance is included for future retirees to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

## 5. Analysis of Contributions Receivable and Benefits Payable

### Contributions Receivable

	2014-15			2015-16		
	Orkney Islands Council £000	Admitted Bodies £000		Orkney Islands Council £000	Admitted Bodies £000	
Employee Contributions	1,863	225	2,088	1,954	252	2,206
Employer Contributions	6,533	752	7,285	6,990	845	7,835
Strain Costs	-	-	0	11	-	11
<b>Total</b>	<b>8,396</b>	<b>977</b>	<b>9,373</b>	<b>8,955</b>	<b>1,097</b>	<b>10,052</b>

### Benefits Payable

	2014-15			2015-16		
	Orkney Islands Council £000	Admitted Bodies £000		Orkney Islands Council £000	Admitted Bodies £000	
Pensions Paid	3,655	353	4,008	3,869	365	4,234
Dependants Pensions	309	29	338	324	28	352
Lump Sums Paid	1,121	52	1,173	1,109	104	1,213
Death Grants Paid	78	-	78	300	6	306
<b>Total</b>	<b>5,163</b>	<b>434</b>	<b>5,597</b>	<b>5,602</b>	<b>503</b>	<b>6,105</b>

Orkney Islands Council, the administering authority, is at present the only scheduled body.

## 6. Transfers In

Transfers in to the scheme during 2015-16 were £0.998m (2014-15: £0.288m). This represents the total of transfer values in respect of individual members joining the scheme.

## 7. Payments to and on Account of Leavers

2014-15 £'000		2015-16 £'000
(23)	Contributions Returned	(23)
(273)	Individual Transfers to other Schemes	(437)
(9)	State Scheme Premiums	(10)
<b>(305)</b>		<b>(470)</b>

8. Investment Income

	2014-15 £'000	2015-16 £'000
<b><u>Equities</u></b>		
Equities UK	1,984	2,341
Equities Global	<u>1,510</u>	<u>1,746</u>
<b>Total Equities</b>	<b>3,494</b>	<b>4,087</b>
<b><u>Fixed Income</u></b>		
UK Bonds	673	634
Overseas Bonds	519	463
Indexed Linked	<u>182</u>	<u>80</u>
<b>Total Fixed Income</b>	<b>1,374</b>	<b>1,177</b>
<b><u>Diversified Growth</u></b>		
Other	<u>714</u>	<u>807</u>
<b>Total Diversified Growth</b>	<b>714</b>	<b>807</b>
<b>Total Cash and Deposits</b>	<b><u>13</u></b>	<b><u>20</u></b>
<b>Totals</b>	<b>5,595</b>	<b>6,091</b>

9. Change in the Market Value of Investments – (Net Capital Gains)

2014-15 £'000		2015-16 £'000
9,542	Realised	2,910
17,746	Unrealised	(9,181)
<b>27,288</b>	<b>Total</b>	<b>(6,271)</b>

**10. Analysis of Investments**

As at 31 March 2016 the market value of the assets under management is as follows:

	31 March 2015	31 March 2016
<b>Baillie Gifford</b>	<b>£'000</b>	<b>£'000</b>
<b><u>Equities</u></b>		
Equities UK	61,672	59,439
Equities Global	127,543	122,930
Equities Small Companies	<u>2,367</u>	<u>2,380</u>
<b>Total Equities</b>	<b>191,582</b>	<b>184,749</b>
<b><u>Fixed Income - Pooled Investment Vehicles</u></b>		
UK Corporate Bonds	12,534	12,495
UK Government Gilts	7,673	7,927
UK Government Gilts (Indexed Linked)	8,923	9,044
Overseas Bonds	9,228	9,489
<b>Total Fixed Income</b>	<b>38,358</b>	<b>38,955</b>
<b><u>Diversified Growth</u></b>		
Other	<u>28,861</u>	<u>31,186</u>
<b>Total Diversified Growth</b>	<b>28,861</b>	<b>31,186</b>
<b>Total Cash and Deposits</b>	<b><u>2,716</u></b>	<b><u>10,040</u></b>
<b>Totals</b>	<b>261,517</b>	<b>264,930</b>

All investments are publicly traded on recognised stock exchanges.

**11. Reconciliation of Movements in Investments**

Investments increased in value to £264.9m as at 31 March 2016 (31 March 2015: £261.5m) a movement of £3.4m.

During 2015-16, sales of investments totalled £26m and purchases totalled £28m. Transaction costs are included in the cost of purchases and sales proceeds.

The following individual investment exceeds 5% of the total value of the net assets of the Pension Fund at 31 March 2016.

	2015	2016
	£'000	£'000
Baillie Gifford & Company - (Diversified Growth Fund)	28,861	31,186

## 12. Investment Transactions

2015-16	Opening Market Value	Purchases	Sales	Change in Market Value	Closing Market Value
	£'000	£'000	£'000	£'000	£'000
<b>Investment Assets</b>					
Equities	189,215	23,836	(26,043)	(4,638)	182,370
<b>Managed Funds</b>					
Pooled Investment – British Small Companies	2,367	-	-	13	2,380
Pooled Investment – Fixed Interest	38,358	1,177	-	(581)	38,954
Pooled Investment – Diversified Growth	28,861	3,390	-	(1,065)	31,186
<b>Managed Funds Subtotal</b>	<b>69,586</b>	<b>4,567</b>	<b>-</b>	<b>(1,633)</b>	<b>72,520</b>
<b>Total Transactions</b>	<b>258,801</b>	<b>28,403</b>	<b>(26,043)</b>	<b>(6,271)</b>	<b>254,890</b>
<b>Cash Deposits</b>	<b>2,716</b>				<b>10,040</b>
<b>Internal Net Current Assets / (Liabilities)</b>	<b>1,616</b>				<b>1,019</b>
<b>Total</b>	<b>263,133</b>				<b>265,949</b>

2014-15	Opening Market Value	Purchases	Sales	Change in Market Value	Closing Market Value
	£'000	£'000	£'000	£'000	£'000
<b>Investment Assets</b>					
Equities	163,201	30,072	(27,241)	23,183	189,215
<b>Managed Funds</b>					
Pooled Investment – British Small Companies	2,207	-	-	160	2,367
Pooled Investment – Fixed Interest	32,294	4,483	(778)	2,359	38,358
Pooled Investment – Diversified Growth	26,561	714	-	1,586	28,861
<b>Managed Funds Subtotal</b>	<b>61,062</b>	<b>5,197</b>	<b>(778)</b>	<b>4,105</b>	<b>69,586</b>
<b>Total Transactions</b>	<b>224,263</b>	<b>35,269</b>	<b>(28,019)</b>	<b>27,288</b>	<b>258,801</b>
<b>Cash Deposits</b>	<b>3,010</b>				<b>2,716</b>
<b>Internal Net Current Assets / (Liabilities)</b>	<b>466</b>				<b>1,616</b>
<b>Total</b>	<b>227,739</b>				<b>263,133</b>

**13. Current Assets**

	31 March 2015 £000's	31 March 2016 £000's
Income Due	652	604
Recoverable Tax	140	229
Cash Balances	82	75
Pending Transfers In	-	509
Contributions due from Employers	55	70
Orkney Islands Council	904	54
<b>Total Current Assets</b>	<b>1,833</b>	<b>1,541</b>

**14. Current Liabilities**

	31 March 2015 £000's	31 March 2016 £000's
Orkney Islands Council	-	-
Other entities and individuals external to general government	217	522
<b>Total Current Liabilities</b>	<b>217</b>	<b>522</b>

**15. Management Costs**

	2014-15 £'000	2015-16 £'000
<b>Investment Management Expenses</b>		
Investment managers fees	612	788
Custodian fees	26	28
Other Investment management expenses	11	6
Stamp Duty	46	43
<b>Total Investment Management Expenses</b>	<b>695</b>	<b>865</b>
<b>Administration Costs</b>		
Staff time and Support allocations	<u>153</u>	<u>159</u>
<b>Total Administration Costs</b>	<b>153</b>	<b>159</b>
<b>Governance</b>		
Audit costs	23	21
Professional fees	<u>52</u>	<u>50</u>
<b>Total Governance Costs</b>	<b>75</b>	<b>71</b>
<b>Total</b>	<b>923</b>	<b>1,095</b>

The investment management arrangement with Baillie Gifford does not include additional fees for out-performance.

## 16. Audit Fees

In 2015-16 the agreed audit fee for the year was £21,000: (2014-15 £22,970).

## 17. Agency Arrangements

The Orkney Islands Council Pension Fund pays discretionary awards to former employees of Orkney Islands Council. The amounts paid are not included within the Fund Account but are provided as a service and fully reclaimed from the council. The total amount of these payments was £285k in 2015/16 and £283k in 2014/15.

Existing contracts entered into by members of the Orkney Islands Council Pension Fund who elected before 1st April 2008 to purchase added years of membership continue in force (unless the member elects to cease the contract). Administration of added years' contracts is carried out by the Orkney Islands Council Pension Fund on behalf of Orkney Islands Council. Costs borne by the fund relating to added years are incorporated into the overall administration cost and are immaterial in value.

## 18. Statement of Investment Principles and Funding Strategy Statement

The Council as Administering Authority approved its current Statement of Investment Principles in 2013. The Statement defines the Fund's operational framework insofar as investments are concerned. It is reviewed periodically to ensure that it continues to reflect the needs of the Fund and the views of its stakeholders.

The Funding Strategy Statement defines how the Fund intends to meet its financial obligations and was effective from 30 March 2015.

Both these documents are published on the Council's web site and are available on request from the Council's Head of Finance.

## 19. Investment Management Arrangements

The Orkney Islands Council Pension Fund investments are managed on an active basis by external fund manager Baillie Gifford.

From the 1 July 2006 the benchmark has been the WM Local Authority Average. The target is to outperform the WM Local Authority (excluding Property) Universe by 1% p.a. over rolling five year periods.

## 20. Stock Lending

In accordance with the Statement of Investment Principles 2013, stock lending is not permitted within any of its segregated investment mandates. As at 31 March 2016 no stock had been released to a third party under a stock lending arrangement.

## 21. Related Party Transactions

Orkney Islands Council Pension Fund is administered by Orkney Islands Council. The Council incurred costs of £0.159m (2014-15: £0.153m) in relation to administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Pension Fund and contributed £6.99m to the fund in 2015-16 (2014-15: £6.5m). With exception of the year end debtor balance shown at Note 13 all monies owing to and from the Fund were paid in the year.

The Fund had a balance due from the Orkney Islands Council of £0.054m as at 31 March 2016 (The fund had a balance due to Orkney Islands Council of £0.904m as at 31 March 2015).

All the members of the Pensions Sub-Committee and the members of the Pensions Board are active members of the pension scheme. Each Councillor is required to declare their interests at each meeting.

The employees who hold key positions in the financial management of the Pension Fund; and their financial relationship with the fund (expressed as cash-equivalent transfer values) are set out below:

	Accrued pension 2014-15		Accrued pension 2015-16	
	Pension	Lump Sum	Pension	Lump Sum
	£	£	£	£
Chief Executive	36,443	78,185	39,067	79,247
Executive Director of Corporate Services	35,249	79,979	37,561	81,191
Head of Finance / Section 95 Officer	24,827	48,815	27,165	49,917

## 22. Membership Details

Under the Local Government Pension Scheme (LGPS), member contributions are paid on a tiered basis, the contribution rate being determined by the amount of salary falling into each earnings tier.

### Eligibility to join the scheme

Orkney Islands Council employees with a contract for 3 months duration or more are automatically entered into the LGPS. Employees with a contract of less than 3 months duration can opt to join the LGPS. However, employees with a contract of less than 3 months duration will be automatically enrolled onto the LGPS if they satisfy the automatic enrolment criteria.

A person employed by a community admitted body or a person employed by a transferee admitted body may only be a member if the person, or class of employees to which the person belongs, is designated in the admission agreement by the body as being eligible for membership of the Scheme.

If they satisfy the above statement they should be automatically entered into the LGPS if they have a contract for 3 months or more otherwise they can opt in if they have a contract for less than 3 months.

These employees are not necessarily auto-enrolled at present, depending on the staging date of each employer.

**Note 22 (Continued)**

The following table gives details of the various bodies' membership.

<b>Membership Details at 31/03/2016</b>	<b>Active</b>	<b>Deferred</b>	<b>Pensioner</b>	<b>Dependant</b>
Orkney Islands Council	1,730	778	629	99
Orkney Islands Property Development	2	6	2	0
Weyland Farms Limited	0	3	1	0
Orkney Towage Company Limited	15	18	17	1
Pickaquooy Centre Trust	54	19	4	0
Orkney Enterprise	5	4	2	0
Orkney Tourist Board (Visit Scotland)	1	5	2	0
Orkney Ferries Limited	81	46	18	3
D & H Glue	0	1	1	0
<b>Summary of Members</b>				
OIC	1,730	778	629	99
Admitted Bodies	158	102	47	4
<b>Totals</b>	<b>1,888</b>	<b>880</b>	<b>676</b>	<b>103</b>

In addition to the above membership table the following bodies have no active members and their liabilities are being calculated by the Actuary and will be assumed by the Council; Drinkwise Orkney, Orkney Meat Limited and Orkney Opportunities Centre. The total liabilities of these entities are not material in relation to the overall value of the fund.

The following admitted bodies had no active members and were deemed to have ceased as an active employer in the Fund of 31 March 2016: Weyland Farms Limited and D&H Glue.

**23. Scheme Arrangements****Career Average Revalued Earnings Scheme (CARE) – LGPS 2015**

A number of important changes have been made to the LGPS from 1 April 2015. The changes, which have been agreed between the Trade Unions, COSLA and the Scottish Government, ensure that the Scheme complies with the terms of the Public Pensions Act 2013.

From 1 April 2015 the pension Scheme moved away from a final salary to a career average revalued earnings scheme (CARE).

The main changes of this scheme were:

- A move towards benefits being worked out using career average revalued earnings (CARE) rather than final salary;
- Pensions being built up at a rate of 1/49th of annual pensionable pay;
- Member's normal retirement age being linked to their own State Pension Age. Members may still be able to retire from age 60 but a reduction for early payment may apply;
- Protection of benefits for members aged 55 and over at 1 April 2012 who will be guaranteed that their benefits will not be less than they would have been if the 2015 scheme had never been introduced; and
- Benefits built up before April 2015 will continue to be calculated using actual final pensionable pay at date of leaving.

## 24. Financial Instruments

### Categories of Financial Instruments

The following categories of financial instrument are carried in the Net Assets Statement:

Financial Instruments Balances	31 March 2015	31 March 2016
	£'000	£'000
<b>Investments</b>		
Financial Assets at fair value through profit/loss	258,801	254,890
Loans and receivables - cash and cash equivalents	2,716	10,040
<b>Total investments</b>	<b>261,517</b>	<b>264,930</b>
<b>Current assets and liabilities</b>		
Debtors	1,833	1,541
Financial liabilities at amortised cost	(217)	(522)
<b>Total current assets and liabilities</b>	<b>1,616</b>	<b>1,019</b>

### Income, Expenses, Gains and Losses

Financial Instruments Gains/Losses	31 March 2015	31 March 2016
	Financial Assets	
	£'000	£'000
Net gains/(losses) on financial assets at fair value through profit and loss	27,288	(6,271)
Investment Income	5,595	6,091
Investment management expenses including taxation	(1,020)	(1,479)
<b>Total investment gains and losses</b>	<b>31,863</b>	<b>(1,659)</b>

### Fair Values of Assets and Liabilities

Financial assets represented by investments are carried in the Net Assets Statement at their current market value (bid price), as determined by the investment manager and the global custodian, based upon publicly quoted prices. This provides a close approximation to fair value.

## 25. Risk and Risk Management

The Fund's primary long-term risk is that the Fund's assets fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. Responsibility for managing the Fund's risk rests with the Pension Fund Sub-committee.

### 25.1 Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk

exposure depends on market conditions, expectations of future price and yield movements and the asset mix. The objective of the Funding Strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Council and its Investment Advisors undertake appropriate monitoring of market conditions and benchmark analysis.

### Sensitivity analysis

In consultation with the Fund's independent provider of performance and analytical data (WM), the Council has determined that the following movements in market price risk are reasonably possible for the reporting period.

Asset Type	Potential Market Movement +/- (%p.a.)
UK Equities	12.13
Global Equities	11.40
Bonds & Index Linked	8.27
Cash	0.01
Diversified Growth	4.93

Potential price changes are determined based on the observed historical volatility of asset class returns. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. Had the market price of the Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows:

			Potential change in year in the net assets available to pay benefits	
Asset Type	Value	% Change	Favourable Market Movement	Unfavourable Market Movement
	£'000		£'000	£'000
UK Equities	59,439	12.13%	66,649	52,229
Global Equities	122,930	11.40%	136,944	108,916
Bonds & index Linked	41,335	8.27%	44,753	37,917
Cash	10,040	0.01%	10,041	10,039
Diversified Growth	31,186	4.93%	32,723	29,649
<b>Total Assets</b>	<b>264,930</b>		<b>291,111</b>	<b>238,749</b>

### 25.2 Interest rate risk

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the Council and its Investment Advisers, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The Fund's direct exposure to interest rate movements as at 31 March 2016 and 31 March 2015 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

	31 March 2015	31 March 2016
	£'000	£'000
Cash and cash equivalents	2,716	10,040

### Sensitivity analysis

The Council recognises that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a 1% change in interest rates:

Asset Type	Carrying amount as at 31 March 2016	Potential change in year in the net assets available to pay benefits	
		1%	-1%
	£'000	£'000	£'000
Cash and Cash Equivalents	10,040	100.4	(100.4)
<b>Total change in assets available</b>	<b>10,040</b>	<b>100.4</b>	<b>(100.4)</b>

### 25.3 Currency exposure risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£UK). The Fund is invested in equities overseas that are denominated in currencies other than £UK. The Fund also holds a low level of bonds denominated in overseas currencies.

The following table summarises the Fund's currency exposure at 31 March 2016:

Currency exposure - asset type	Asset value	Asset value
	31 March 2015	31 March 2016
	£'000	£'000
Overseas Quoted Equities	124,513	118,824
Pooled Funds - Global Basket	3,030	4,106
<b>Total</b>	<b>127,543</b>	<b>122,930</b>

## Sensitivity analysis

Following analysis of historical data in consultation with WM, the likely volatility associated with foreign exchange movements on an individual currency basis is shown on the table below. The weight of each currency in relation to the total currency basket is multiplied by the change in its exchange rate (relative to GBP) to create the aggregate potential currency change of the 'basket' as follows:

Currency	Value	% Change	Value on Increase	Value on Decrease
	£		£	£
Australian Dollar	1,362,075	9.26%	1,488,203	1,235,947
Brazilian Real	771,241	13.89%	878,366	664,116
Danish Krone	2,429,816	6.83%	2,595,772	2,263,860
Canadian Dollar	1,555,591	7.89%	1,678,327	1,432,855
EURO	10,082,597	6.77%	10,765,189	9,400,005
Hong Kong Dollar	3,185,646	7.67%	3,429,985	2,941,307
Japanese Yen	8,000,782	11.68%	8,935,273	7,066,291
Norwegian Krone	1,491,751	9.40%	1,631,976	1,351,526
South African Rand	4,432,426	10.31%	4,889,409	3,975,443
South Korean Won	423,116	7.22%	453,665	392,567
Swedish Krona	3,555,426	7.65%	3,827,416	3,283,436
Swiss Franc	3,287,340	9.95%	3,614,430	2,960,250
US Dollar	78,246,461	7.78%	84,334,036	72,158,886
Pooled Assets	4,106,210	5.99%	4,352,172	3,860,248
<b>Total</b>	<b>122,930,478</b>		<b>132,874,219</b>	<b>112,986,737</b>

### 25.4 Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities. The selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

The Council's Annual Treasury Management Strategy Statement sets out the Fund's approach to credit risk for internally managed funds. Deposits are not made with banks and financial institutions unless they are rated independently and meet the Council's credit criteria. The Strategy has also set limits as to the maximum percentage of the deposits placed with any one class of financial institution.

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its treasury management arrangements at 31 March 2016, including current account cash, was £75k. (31 March 2015: £82k). The Fund also held cash under its investment management arrangement. This was held with the following institutions:

	Rating (Fitch)	Balance 31 March 2016 £'000s
<b>Bank current accounts</b>		
Royal Bank of Scotland	BBB+	75
<b>Cash held in Portfolio</b>		
Handelsbanken	AA-	3,900
Bank of New York Mellon (BNY)	AA	3,600
HSBC Deposit	AA-	2,000

## 25.5 Liquidity Risk

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council therefore takes steps to ensure that the Pension Fund has adequate cash resources to meet its commitments.

The Council has immediate access to its Pension Fund cash holdings

The Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three months to convert into cash. As at 31 March 2016, the Fund had no illiquid assets.

## 26. Funding and Valuation Note

In line with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, the Fund's actuary undertakes a funding valuation every three years. The actuarial valuation assesses the health of the fund and provides a check that the funding strategy and assumptions used are appropriate. It also sets the future rates of contributions payable by employers. The most recent full actuarial valuation by the Fund's actuaries Hymans Robertson was to 31 March 2014. The next valuation will take place as at 31 March 2017.

The key elements of the funding policy are:

- To ensure the long-term solvency of the Fund, i.e. that sufficient funds are available to meet all pension liabilities as they fall due for payment.
- To ensure that employer contribution rates are as stable as possible.
- To minimise the long-term cost of the scheme by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return.
- To reflect the different characteristics of employing bodies in determining contribution rates where the administering authority considers it reasonable to do so.
- To use reasonable measures to reduce the risk to other employers and ultimately to the council tax payer from an employer defaulting on its pension obligations.

The aim is to maintain 100% solvency over a period of 20 years and to provide stability in employer contribution rates by spreading any increases in rates over a period of time. Solvency is achieved when the funds held, plus future expected investment returns and contributions are sufficient to meet expected future pension benefits payable.

At the 2014 actuarial valuation, the Fund was assessed as 114.4% funded (106.3% at the March 2011 valuation). This corresponded to a surplus of £29m (2011 valuation: surplus of £9m) at that time.

The assessed common contribution rate (i.e. the rate which employers in the Fund pay) at March 2014 was 15.2% (2011 assessed common contribution rate 16.5%).

Owing to volatility in the financial markets in the year following the actuarial review, it was decided to hold the pooled contribution rate at its previous level of 21.4% for the 2015/16 year with a reduction in the rate to 19.8% in 2016/17 and 19.2% in 2017/18.

In accordance with the Funding Strategy Statement the administering authority has adopted employer contributions from 2013/14 to 2015/16 of 21.4%. The valuation of the Fund has been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service. The principal assumptions were:

### Financial Assumptions

Financial Assumptions	31-Mar-11	31 March 2014	
	Funding basis (% p.a.)	Funding basis (% p.a.)	Gilts basis (% p.a.)
Discount rate	5.90%	5.10%	3.50%
Price inflation	3.60%	3.50%	3.50%
Pay increases	5.10%	4.50%	4.50%
Pension increases:			
in excess of GMP	2.80%	2.70%	2.70%
post-88 GMP	2.80%	2.70%	2.70%
pre-88 GMP	0.00%	0.00%	0.00%
Revaluation of deferred pension	2.80%	2.70%	2.70%
Revaluation of accrued CARE pension		2.70%	2.70%
Expenses	0.80%	1.00%	1.00%

\* GMP = guaranteed minimum pension

### Mortality assumptions

The mortality assumptions used and applied to all members are based on the Self-Administered Pension Schemes year of birth tables with no further improvements in lifespans estimated from 2014.

### 27. Additional Voluntary Contributions

Under Inland Revenue rules, scheme members are permitted to make contributions towards retirement and death in service benefits in addition to those which they are required to make as members of the Local Government Pension Scheme. These contributions are known as Additional Voluntary Contributions and are treated separately from the scheme's assets under arrangement with Prudential Assurance Company Limited.

During the year, member contributions amounted to £0.370m (2014-15: £0.370m).

Members contributions are invested in a “with profits” Fund or a “deposit” Fund. During the year the value of AVC investments increased by £0.352m to £2.582m as at 31 March 2016 (2015: £2.230m) excluding the final bonus.

## **28. Contingent Liabilities and Contractual Commitments**

Following the Freedom and Choice provisions announced in the 2014 Budget, the Pension Fund has had an increase of enquiries from members about transferring benefits out of the LGPS. Illustrations provided to members indicate that at the year-end there are potential liabilities of £186k in respect of members who may exercise the option to take benefits out of the scheme.

## **29. Post Balance Sheet Event – EU Referendum**

The vote to leave the European Union on 23<sup>rd</sup> June 2016 may have an effect on the pension fund. Initial reactions included an 8.7% slump across the FTSE 100 index upon the financial markets opening on the 24 June 2016, together with the pound hitting a 30 year low against the dollar. While this level of extreme volatility is expected to subside in the near term, the prospects of a reduction in UK GDP growth expectations are likely to weight on both equity markets and interest rates going forward.

Since then the Pension Fund has seen a 13% increase in the value of its investments to 31 August 2016, driven mainly through its exposure to overseas investments which has benefited from exchange rate currency gains as a result of the devaluation in the pound sterling. Against this however, a fall in government bond yields together with a lowering of expected future returns on investments is such that the funding level of the Pension Fund as a whole has fallen from 102% to 96% since 31 March 2016.

## INDEPENDENT AUDITOR'S REPORT

### Independent auditor's report to the members of Orkney Islands Council as administering body for Orkney Islands Council Pension Fund and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2016 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 (the 2015/16 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

#### Respective responsibilities of the Head of Finance and auditor

As explained more fully in the Statement of Responsibilities, the Head of Finance is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

#### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Head of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

#### Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2015/16 Code of the financial transactions of the fund during the year ended 31 March 2016, and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2015/16 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

#### Opinion on other prescribed matter

In my opinion the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which I am required to report by exception**

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Stephen Boyle CPFA  
Assistant Director  
Audit Scotland  
4th Floor South Suite  
The Athenaeum Building  
8 Nelson Mandela Place  
Glasgow G2 1BT

19 September 2016

## **ANNEX 1 - Scheduled and Admitted Bodies**

### **Orkney Islands Council Pension Fund**

#### **Scheduled Bodies**

- Orkney Islands Council

#### **Admitted Bodies**

##### **Active Admitted Bodies**

- Orkney Tourist Board (Visit Scotland)
- Orkney Towage Company Limited
- Orkney Ferries Limited
- Orkney Enterprise
- Pickaquoy Centre Trust
- Orkney Islands Property Development Limited

##### **Admitted bodies with Deferred or Retired Members only**

- D & H Glue (ceased 1<sup>st</sup> April 2015)
- Weyland Farms Limited (ceased 1<sup>st</sup> April 2015)

## **ANNEX 2 – Actuarial Statement for 2015-16**

### **Orkney Islands Council Pension Fund (the Fund)**

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

#### **Description of Funding Policy**

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2015. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (NB this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

#### **Funding Position as at the last formal funding valuation**

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £227 million, were sufficient to meet 114% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2014 valuation was £29 million.

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

#### **Principal Actuarial Assumptions and Method used to value the liabilities**

Full details of the methods and assumptions used are described in the valuation report dated 30 March 2015.

##### **Method**

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

##### **Assumptions**

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial assumptions	31-Mar-14	
	% p.a. Nominal	% p.a. Real
Discount rate	5.10%	2.40%
Pay increases	4.50%	1.80%
Price inflation/Pension increases	2.70%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI\_2012 model, assuming the current rate of improvements has reached a peak and will converge to the long term rate of 1.25%p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.4 years	23.8 years
Future Pensioners	25.0 years	27.0 years

\*Future pensioners are assumed to be currently aged 45

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from Orkney Islands Council, Administering Authority to the Fund.

#### Experience over the period since April 2014

Experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bonds yields have fallen dramatically placing a higher value on liabilities. The effect of this has been only partially offset by the effect of strong asset returns. Funding levels are therefore likely to have worsened over the period.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.

#### Barry McKay FFA

Fellow of the Institute and Faculty of Actuaries  
 For and on behalf of Hymans Robertson LLP  
 27 April 2016

Hymans Robertson LLP  
 20 Waterloo Street  
 Glasgow G2 6DB

## **ANNEX 3 - Glossary of Terms**

### **ACTIVE MANAGEMENT**

An investment management style that seeks to outperform by way of self-selected decisions on stock choice, timing of market incursions, or asset allocation. Compare this with Passive Management.

### **ASSET ALLOCATION**

The division of the Fund's assets between different classes of assets, for example, UK Equities, Japanese Equities, UK Bonds. In the long run the asset allocation choices should support the Fund's strategic financial objectives. In the short term tactical changes might be made to achieve short-term advantage.

### **BALANCED MANAGEMENT**

An arrangement under which investments are spread over a range of asset classes at the manager's discretion. The manager controls investments over as many classes as are available under the Fund's overall strategy. Compare this with specialist management.

### **GROWTH MANAGER**

An investment manager who fundamentally believes in picking stocks that he believes will achieve an above-average growth in profits. This is sometimes caricatured as buying stock irrespective of price because the price will rise. Compare this with value manager.

### **MANDATE**

An agreement between an investment manager and his client as to how investments are to be managed, specifying whatever targets and investment limitations are to apply.

### **PASSIVE MANAGEMENT**

A style of investment management that seeks performance equal to market returns or to some appropriate index. Such investment entails a more mechanical approach to asset allocation and stock selection because such decisions are largely dictated by general market shifts rather than individual manager discretion. Compare this with active management.

### **POOLED FUND**

A fund in which a number of investors hold units rather than owning the underlying assets. This is a useful way for smaller funds to diversify investments without exposing them to undue risks. Unit Trusts are pooled funds as are Open-ended Investment Companies. Compare this with segregated fund.

### **RETURN**

The value of capital enhancement and income received by a fund in a year, expressed as a percentage of the opening value of the fund. If values fall "Return" would be negative.

### **RISK**

The danger or chance that returns will vary against benchmarks or targets. If risks are high the expected return should be higher still (the risk premium).

### **SEGREGATED FUND**

The management of a particular fund's assets independently of those of other funds managed by the same investment house. Compare this with a pooled fund.

**SPECIALIST MANAGEMENT**

The use of a number of managers, each specialising in a particular asset class. Such managers have no say in asset allocation, being only concerned with stock selection.

**VALUE MANAGER**

A manager who selects stocks that he believes to have potential that is not reflected in the price. This is sometimes caricatured as buying stock because it is cheap. Compare this with growth manager.

**VESTED/NON VESTED OBLIGATIONS**

Vested obligations refer to employee benefits that are not conditional on future employment. Non vested obligations refer to employee benefits that are conditional on future employment.

**PENSION FUND STRAIN**

The cost to employers of the early release of pension benefits.

**OPERATING SURPLUS/DEFICIT**

The surplus/deficit arising from dealing with members, employers and others directly involved in the scheme.

## ADDITIONAL INFORMATION

### Key Documents Online

You can find further information on our website [www.orkney.gov.uk/Council/P/pension-fund-annual-reports.htm](http://www.orkney.gov.uk/Council/P/pension-fund-annual-reports.htm), including the following documents:

- Annual Report and Accounts

### Fund Advisers

Actuaries:	Hymans Robertson
Auditors:	Audit Scotland
Bankers:	Royal Bank of Scotland
Investment Advisors:	Hymans Robertson
Investment Custodians:	Bank of New York Mellon
Investment Managers:	Baillie Gifford & Co
Performance Measurement:	WM Performance Services
Additional Voluntary Contributions (AVC) Managers:	Prudential

### Contact Details

For further information and advice on administration, benefits and scheme membership please contact:

Bryan Hay	Telephone 01856 873535	Ext 2108
Pensions Manager	E-mail <a href="mailto:bryan.hay@orkney.gov.uk">bryan.hay@orkney.gov.uk</a>	

Scheme members should have a copy of the "Employees' Guide to the Local Government Pension Scheme Administered by the Orkney Islands Council", and can obtain their own copy of an Annual Report on request or visit Orkney Islands Council Pension Fund website at: [www.orkney.gov.uk](http://www.orkney.gov.uk).

For further information on the Fund's Investments, please contact:

Gareth Waterson	Telephone 01856 873535	Ext 2103
Head of Finance	E-mail <a href="mailto:gareth.waterson@orkney.gov.uk">gareth.waterson@orkney.gov.uk</a>	
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Corporate Finance Senior Manager	E-mail <a href="mailto:colin.kemp@orkney.gov.uk">colin.kemp@orkney.gov.uk</a>	