



# **Annual Report and Accounts of the Orkney Islands Council Pension Fund 2019/2020**



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## **Management Commentary**

### **Introduction**

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2020.

The Local Government Pension Scheme (Scotland) Regulations 2018 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 administration and performance of the fund for financial year 2019-2020 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, important that members take the 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 pooled investment vehicles.

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 2020 was £376.6 million (£390.7m at 31 March 2019).

An Operational and Investment Income Loss of £14.1 million was incurred on the activities of the fund (compared to a surplus of £24.3m for the year ended 31 March 2019).

The decrease in fund value over the year was largely the result of a loss on market value of investments of £22.3m. Further outflows, including benefits payable (£8.9m) and management expenses (£2.1m) were offset by investment income of £8.2m and contributions receivable of £10.3. Overall this represents a year on year decrease of 3.6% in the value of the fund.

Performance of the Fund on a three year rolling average basis has been 3.4% p.a., giving a relative return above benchmark of 0.5%.

Fund membership increased by 147 to 4,048.

Employers contributed £7.6 million to the Fund (£7.5m to 31 March 2019).

Employees contributed £2.7 million (£2.5m to 31 March 2019).

Pension and other benefits paid out were £8.9 million (£7.4m to 31 March 2019).

Transfer values paid into the Fund because staff changed employers was £1.1 million (£0.8m to 31 March 2019).

Transfer values out of the Fund because staff changed employers was £0.4m (£0.7m to 31 March 2019).

The past year has proved to be a challenging year for investors in general, with global financial markets registering significant losses across most asset classes with the possible exception of bonds. Following a sustained period of strong investment performance throughout 2019, a sharp correction in Quarter 1 of 2020 saw the financial markets close the year well down. Much of the volatility in the markets was caused by concern over the outbreak of Covid-19, and the extent of the restrictive measures being imposed by respective Governments resulted in the shutdown of entire economies across the developed world in an attempt to prevent the spread of the virus.

Over the 12 months to 31 March 2020, the Pension Fund's investments returned a loss of 4.1% which was 1.9% behind the fund specific benchmark. Returns from the Fund have performed ahead of its benchmark over each of the previous 3, 5 and 10-year periods. The target is for the fund manager to outperform the aggregate benchmark over a rolling 5-year period.

The benchmark return of -2.2% generally reflects variable market conditions for investors during the year.

The table shown within the Investment strategy section, page 5, details the allocation of the fund within asset class or pooled investment vehicle.

The value of the fund decreased by £14.1m or 3.6% in the financial year and totalled £376.6m at 31 March 2020.

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 a net capital loss of £22.3m (2019: £15.2m gain) was offset by income into the fund from dividends and interest of £8.2m (2019: £8.1m), and a surplus of member contributions receivable over pension payments and management expenses of £0.07m (2019: £1.1m).

The Accounts are based on the market value of investments at 31 March 2020. 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 2020 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 £22.3m in the year, £42.1m was an unrealised loss (2019: £1.6m loss) and £19.8m (2019: £16.8m) realised profit.

After allowing for projected liabilities on the fund, the funding level has dropped to 104.6% at 31 March 2020 from its value of 115.3% last financial year end, calculated on an ongoing funding basis. The primary cause of this decline is a decrease in return on assets, a decline in contributions less benefits accruing and the negative impact of change in yields and inflation.

We are pleased to report that the Fund maintains a position above its 100% funding target, being in surplus by £17m at the financial year end (2018-2019: £52m) according to the actuary's most recent funding update.

### **Investment Trends and Influences**

The Fund is measured against a bespoke or fund specific benchmark reflecting the composite performance of the respective asset classes adjusted for weighting of the Fund assets.

The Fund's investments continue to be actively managed primarily by investment managers Baillie Gifford who have provided the following commentary:

"Investment markets made good progress over much of 2019 and actually started 2020 in a relatively calm fashion too, carrying through many of the same opportunities and risks which defined the global economy towards the end of 2019, with a focus on trade and latterly the progress on US-China trade negotiations at the forefront. However, as the international effects of Covid-19 began to emerge in mid-February, areas such as listed equities and property – two of the more economically exposed asset classes – began to fall in value. Shortly after this, there was a much more synchronised sell-off across a broad range of asset classes as a sense of the scale around the potential impact of the coronavirus (Covid-19) gained momentum and many investors raised money to meet outflows, to cover collateral requirements or, more simply, to hold a greater percentage of their assets in cash.

All markets have experienced extreme levels of volatility. Conditions in bond markets have proven to be particularly challenging and, at the same time, property related

investments suffered substantial price falls as it became clear that rent collection and dividend payments would be impacted in the near term. What has become painfully apparent for the corporate world and financial markets more broadly is how many businesses and whole economic sectors have effectively been put on hold. From an investment perspective, this is a scenario without precedent, and diversification has proved less helpful than would have been hoped in the short term.

Nonetheless, despite the traumas of the first quarter of 2020 the fund's investments [managed by Baillie Gifford] have held up well over the year as a whole, falling some 3.7% after fees in a year when global equities fell over 6%. This is in large part due to the strong relative performance of the global equity portfolio which is the largest part of the fund. Generally, this has been helped by the strong operational performance and resilience of the underlying holdings and it is this which has also helped both the global and UK equity portfolios to outperform over the last five years – a more meaningful period over which to judge performance given Baillie Gifford's long-term approach. We continue to adopt a long-term, low-turnover, stock driven, fundamental approach and it is thus the operational performance of the fund's holdings which will determine returns over the long term.

As we look forward from here, we are cautious around the prospects for economic activity and markets in general. We expect the impacts of the virus to be long-lasting, with some freedoms curtailed for an extended period. When looking out over the longer term, however, we retain our optimism. We do not believe this crisis will fundamentally change the global economy's ability to generate growth: once we emerge from it, we believe it is likely that the very extensive and supportive policies which have been implemented, in combination with energy prices at 20-year lows, will allow a reasonable recovery.

Accordingly, within the fund's multi-asset investments there will be a time to significantly add economic risk exposure, and we will continue to work hard towards identifying those assets we would buy at the point at which we consider both valuations and economic outlook to be suitably compelling. In the meantime, we remain optimistic about the fund's equity investments, and about their ability to exploit their competitive advantages even in a challenging environment.”

## 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 inherent risks that accompany any investment in the respective asset classes. The strategy is set out in the Statement of Investment Principles which can be viewed on request.

A revised investment strategy was approved in February 2019. The process of transitioning to the revised strategy started during 2019 with the selection, appointment and onboarding of new fund managers, but the transition of investments was subsequently delayed in Quarter 1 2020 due to the impact of Covid-19 on the financial markets. The revised asset allocation and range guidelines were applied with effect from December 2019 and are shown in the Asset Allocation table below together with the actual asset allocation at 31 March 2020

Asset Class	Asset Allocation at 31/03/2020	Range	Fund Specific
		Guideline	Benchmark
<b>Growth</b>			
UK Equities	9.1%	41-61	8.0
Overseas Equities	52.1%		43.0
Global Pooled - Diversified/Multi-Asset Growth	24.6%	14-34	24.0
<b>Income</b>			
Infrastructure Credit	0.0%	0-20	5.0
Private Debt	1.7%		5.0
<b>Protection</b>			
UK Gilts	6.2%	5-25	7.5
UK Indexe-Linked Gilts	5.4%		7.5
Cash	0.9%	0-10	0.0
<b>Total</b>	<b>100%</b>		<b>100.0</b>

The Fund has acted to reduce its holdings in growth-seeking assets in favour of funding a new allocation to income generating assets as part of a strategy to further diversify the Fund's investments. Nevertheless, holdings in equities still account for 61.2%, with indirect holdings in Diversified Growth and Multi-Asset Growth pooled funds accounting for a further 24.6% of the Fund's portfolio as at 31 March 2020. The remaining 14.2% is held in Private Debt, Bonds and Cash at 1.7%, 11.6% and 0.9% respectively.

Along with new allocations to infrastructure equity and private debt, other changes included an increase in the bonds allocation which is to be managed passively going forward. These changes are intended to reduce the risk profile of the fund and will be matched by a proportionate reduction in growth assets.

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 dealings with

members which allows it to take a long-term view across successive investment cycles.

The top 10 direct equity holdings within the fund at 31 March 2020 were:

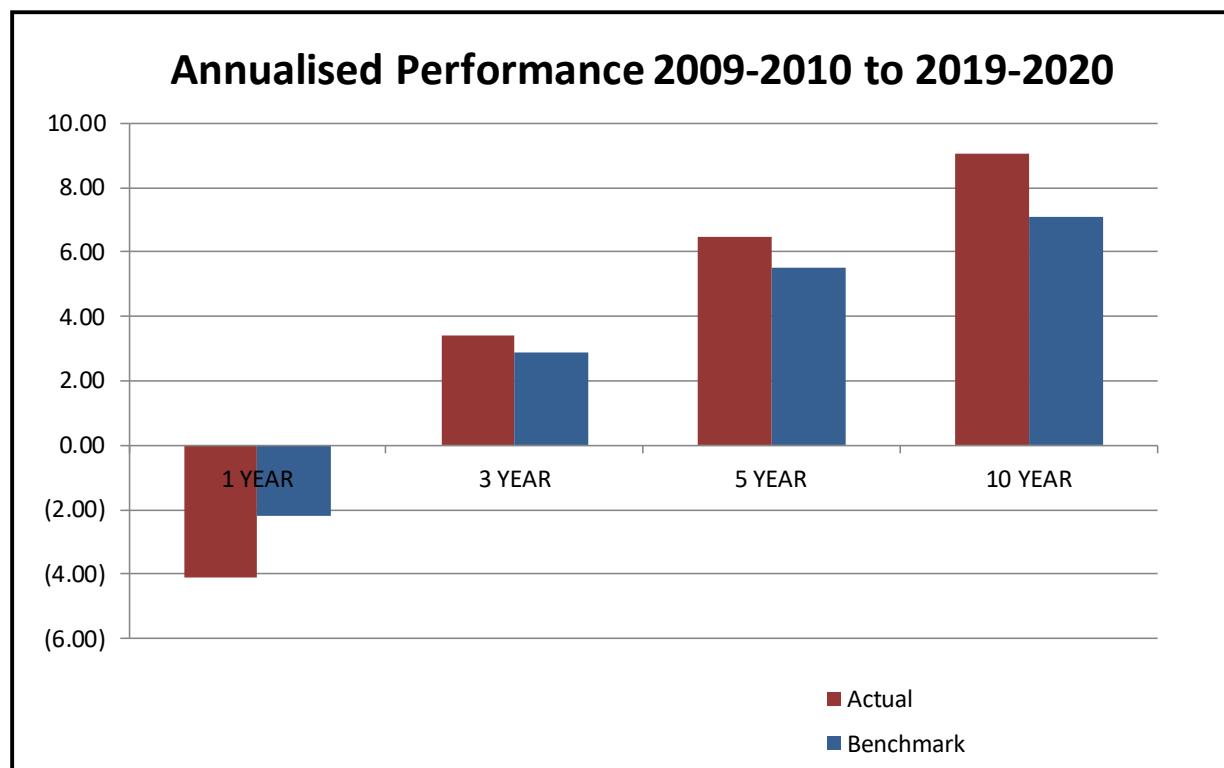
Company	Market Value of Holding £ m
Baillie Gifford Multi Asset Growth Fund C Acc*	52.0
Baillie Gifford Diversified Growth Fund C Acc*	40.7
Amazon.com	7.9
Alibaba	6.5
Naspers	6.2
Prudential	5.9
Moody's	5.8
Alphabet Inc Class C	5.8
UK Treasury 4.25% 07/12/2049	5.5
Microsoft	5.0

\* Capital Accumulated.

## Investment Performance

The performance of the Pension Fund managed investment funds has been measured against a bespoke or fund specific benchmark since the 1 April 2017, following the closure of the previous peer group benchmark, and reflects the weighting or concentration of individual asset classes within the approved investment strategy. The benchmark is maintained by Hymans Robertson. A revised investment strategy was approved in February 2019 and included principally new allocations to infrastructure equity and private debt, funded by a further reduction in the Fund's exposure to equities. The weightings of the fund specific benchmark were subsequently amended in December 2019 to reflect the revised investment strategy and signalled the start of the process to transition the Fund's investments to the new strategy. The Fund's performance target for this accounting period is to outperform the fund specific benchmark measured over a rolling 5-year period. The average performance over the last 5 years of 6.5% remains ahead of the benchmark of 5.5%.

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



## **Structure of Administration**

### **Staffing**

Administration of the Scheme is carried out in-house and undertaken by the Payroll and Pensions section within Orkney Islands Council's Chief Executive's Service.

The Pensions team within the Payroll and Pensions section has 4.0 full time equivalents, consisting of one full time Pensions Manager, two Senior Assistants and an Administrative Assistant. In addition to maintaining scheme members' records using data supplied by all Fund employers, the Pensions team also provides frontline services to scheme members. As well as answering telephone calls and responding to electronic and written correspondence, face to face meetings are provided where requested.

The staff resources detailed above are supplemented by shared staff resources within the Chief Executive's Service, providing additional governance, payments, investment and accounting expertise. In addition, the Human Resources and Performance section, within Orkney Islands Council's Corporate Services also supports the work of the Pension section by arranging pre-retirement workshops for scheme members who are within two years of retirement.

### **Systems**

Scheme members' records are maintained on Aquila Heywood's pensions administration system known as Altair. Every current and former employee of Fund employers, including Orkney Islands Council, who has a pension entitlement in the Fund is included in the Altair system.

The Council's ResourceLink Payroll system is used to pay pensioner benefits. The Pensions team is restricted to read only access of the payroll system, with amendments being made to pensioner records via a formal request process to the Payroll team.

## Administration Performance

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

Administration performance figures monitored by the Pension Fund are currently under review, with a view to ensuring they continue to be relevant and appropriate. Performance for financial year 2019-2020 against the key service standards as set by the Pension Fund Sub-committee is summarised 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
New Entrant Information	10	248	0	100.0%	N/A
Leaver Information	10	128	0	100.0%	N/A
Deferred Benefit Information	1 Month	83	4	95.4%	N/A
Pension Estimates	10	102	1	99.0%	65.0%
Retirements	5	87	0	100.0%	100.0%
Transfers In	10	42	1	97.7%	95.6%
Transfers Out	10	11	0	100.0%	94.7%
Refunds	5	27	0	100.0%	93.6%

## Fund Update

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

Membership	2018-2019	2019-2020
Contributing members	1,969	2,017
Pensioners	974	1,041
Deferred members	958	990
Total	3,901	4,048

<b>Contributing Member</b>	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 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/Dependent Member</b>	Someone who is receiving benefits from the Fund either as a former contributor or as a dependant of a former contributor who has deceased.

## **Employer Bodies**

The Fund invested and administered pensions on behalf of 6 current and former employers during financial year 2019-2020. 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 26 of the Annual Report and Accounts for the Fund.

## **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 financial year 2019-2020 which is prepared in line with 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 2017, revealed that the Fund's assets were valued at £335m, and were sufficient to meet 112.7% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. This compared with 114.4% at the previous March 2014 valuation. The resulting surplus at the 2017 valuation was £38m.

The funding level of the Pension Fund has been maintained broadly in-line with the previous valuation after allowing for a reduction in the future expected investment returns, resulting from a fall in the real gilt yield, and the adoption of a lower Asset Outperformance Assumption than the previous valuation. An increase in liabilities has largely been offset by positive membership experience and better than anticipated investment returns.

Following the Fund's actuary (Hymans Robertson) recommendation, as a result of the valuation process, the contribution rate for 2017-2018 of 19.2% was reduced to 18.2% and 17.6% in 2018-2019 and 2019-2020 respectively, with a further reduction to 17.0% to be applied 2020-21.

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

The most recent funding update produced at 31 March 2020 showed that the funding surplus has decreased since the last full valuation. This can be attributed to a fall in asset returns partially offset by contributions less benefits accruing, coupled with the impact of change in yields and inflation, resulting in a reduction from last year's funding level of 115.3%, to 104.6% at 31 March 2020.

## 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 36 risks faced by the fund and can be viewed at <https://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 Pension Fund 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 Pension Fund 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 Pension Fund Sub-committee seeks to manage systemic risk by the appointment of investment managers. The Pension Fund 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.

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

In line with Scheme regulations, the Pension Fund Sub-committee and Pensions Board are now fully established and, in accordance with the respective terms of reference which were agreed at the first meeting, the group have met concurrently on four occasions during 2019-2020.

Training activity for the members of the Pension Fund Sub-Committee and Pension Board was undertaken during the financial year 2019-2020, in accordance with the agreed training plan, to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively. In recognition of the complex and ever changing environment of Local Government Pension Scheme finance, and specifically to address the governance requirements, the Chartered Institute of Public Finance and Accountancy Code of Practice on Public Sector Pensions Finance Knowledge and Skills has been adopted.

### **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  
26 October 2020



**Councillor James Stockan**  
Leader  
26 October 2020



**John W Mundell, OBE**  
Interim Chief Executive  
26 October 2020

## **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.

**Signed on behalf of Orkney Islands Council**

*Councillor James W Stockan*

**Councillor James Stockan**

Leader

26 October 2020

## 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 2020, and of its transactions for the year ended 31 March 2020.



**Gareth Waterson, BAcc, CA**  
Head of Finance  
26 October 2020

## **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

[https://www.orkney.gov.uk/Council/Statement\\_of\\_Accounts/Statement-of-Accounts.htm](https://www.orkney.gov.uk/Council/Statement_of_Accounts/Statement-of-Accounts.htm).

## Annual Governance Statement

### Scope of Responsibility

The Orkney Islands Council acts as Administering Authority for the Orkney Islands Council Pension Fund. The Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council has a statutory duty to make arrangements to secure best value under the Local Government in Scotland Act 2003.

In discharging this overall responsibility, the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions. This includes arrangements for the management of risk.

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government'. The Code is available on the Council's website. The authority's financial and management arrangements conform to the governance requirements of the CIPFA Statement on the role of the Chief Financial Officer in local government.

The Local Code of Corporate Governance evidences the Council's commitment to achieving good governance and demonstrates how it complies with the governance standards recommended by CIPFA. The document is regularly reviewed and updated.

### Purpose of the Governance Framework

The governance framework comprises the systems and processes, and cultures and values, by which the Council is directed and controlled, and the activities used to engage with and lead the community. It enables the Council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to an acceptable level, and provide reasonable, but not absolute, assurance that the policies, aims and objectives can be delivered. The system of internal control is based on an ongoing process designed to identify and prioritise the risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2020 and up to the date of approval of the Annual Accounts.

### **Purpose of the Governance Framework**

1. Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
2. Ensuring openness and comprehensive stakeholder engagement.
3. Defining outcomes in terms of sustainable economic, social, and environmental benefits.
4. Determining the interventions necessary to optimise the achievement of the intended outcomes.
5. Developing the entity's capacity, including the capability of its leadership and the individuals within it.
6. Managing risks and performance through robust internal control and strong public financial management.

The Pension Fund is governed by the Local Government Pension Scheme (Scotland) Regulations. These include requirements for the preparation and production of a number of key policy documents including a Triennial Valuation Report, a Funding Strategy Statement and Statement of Investment Principles. These documents set out the Fund's objectives together with the main risks facing the Fund and the key controls to mitigate those risks.

### **Review of Effectiveness**

Orkney Islands Council has put in place appropriate management and reporting arrangements to enable it to satisfy itself that its approach to corporate governance is adequate and effective in practice. This includes ensuring appropriate advice is given to the Pension Fund on all governance matters, providing training to all members of the Pension Fund Sub-committee and Pension Board, keeping proper administrative and financial records and accounts and maintaining an effective system of arrangements for governance control.

The system of internal financial controls 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 records 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.

The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and the Council's independent internal audit section. The Pension Fund Sub-committee is integral to overseeing independent and

objective assurance and monitoring improvements in internal control and governance.

### **Administering Authority**

Orkney Islands Council is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Orkney Islands geographic area.

The Council has delegated the management of the investments of the Pension Fund to the Pension Fund Sub-committee and 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 Pension Regulator.

### **Regulatory Framework**

The Pensions Regulator is the UK regulator of work-based pension schemes. It works with trustees, employers, pension specialists and business advisers, giving guidance on what is expected of them.

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.

The Orkney Islands Council scheme is open to all employees of scheduled bodies except 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 as Annex 1.

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.

Financial affairs are conducted in compliance with the Council's Financial Regulations which are reviewed and updated on a regular basis.

Funds are invested in compliance with the Fund's Statement of Investment Principles.

### **Pension Fund Sub-Committee and Pension Board**

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).

Their overriding duty is to ensure the best possible outcomes for the Fund, its participating employers and scheme members.

The members' knowledge is supplemented by professional advice from officers of the Council, professional advisers and other external providers.

The Pension Fund Sub-committee is comprised of seven members of the Council:

- Leader (Chair of Policy and Resources Committee).
- Deputy Leader (Vice Chair of Policy and Resources Committee), and
- Five other elected members of the Council appointed by Policy and Resources Committee.

The Scheme Actuary, the Independent Investment Consultant, Head of Finance, Pensions Manager and the Solicitor for the Council or their nominated representatives also attend the Pension Fund Sub-committee meetings as advisers.

The Pension Fund Sub-committee meets at least quarterly. Additional meetings are called as appropriate and 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 Pension Fund Sub-committee are also presented to the Policy and Resources Committee of the Council.

Membership of the Pensions Board consists of equal numbers made up of 4 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 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.

The Pension Board meets at least quarterly. A majority of either side, trade union or employer representatives, may requisition a special meeting of the Pension Board in exceptional circumstances.

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 Fund Sub-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.

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 defer 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.
- 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, included in the Pension Fund annual report and notified to the Scottish LGPS Advisory Board, and

- 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.

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

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.

The Head of Finance is responsible for:

- The financial accounting of the Fund.
- The preparation of the Pension Fund Annual Report.
- Being the principal advisor on management of investments to the Council in its capacity as Trustee to the Fund and as the Fund's Administering Authority.

The day-to-day management of the investment activities of the Fund is administered by the Corporate Finance Team within the Chief Executive's Service.

The pension benefits policy oversight and day-to-day administration for the Fund is administered by the Pensions Team within the Chief Executive's Service.

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.

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

Hymans Robertson is appointed to act as Actuary and Investment Consultants to the Fund. The services provided include advice on investment strategy, funding level and actuarial valuations. Hymans Robertson also provides independent performance measurement services for the Fund and has responsibility for measuring and reporting on the performance of the Fund during the year.

Following an independent review of the Fund's investment strategy undertaken in financial year 2018-2019 by Hymans Robertson, progress continues to be made in the move away from the 100% asset allocation to a single fund manager, with appointments to new Infrastructure Equity, Private Debt and Passive Bonds mandates concluded.

The Fund's appointed investment managers have responsibility for the selection, retention and disposal of individual investments. Where appropriate, they also implement the Pension Fund Sub-committee's policy in relation to socially responsible investment and corporate governance.

The Bank of New York Mellon is the Fund's appointed global custodian and is responsible for the safekeeping of the assets including the processing of transactions and submission of tax claims.

### **Internal and External Control and Review**

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.
- Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.

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.

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.

The Pensions team within the Payroll and Pension section consists of 4 full time equivalents.

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.

The Chief Internal Auditor (CIA) reports to the Monitoring and Audit Committee and functionally to the Executive Director of Corporate Services. He is in regular contact with the Head of Finance and Monitoring Officer. The CIA provides an independent and objective internal audit annual report and 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.

Given the structural size of the Council, there are common controls over Council systems and pension systems. Internal audit's work on Council systems also contributes to providing management assurance that Pension Fund operations and transactions are appropriately controlled.

## Risk Management

The Fund's Risk Register was last reviewed and updated at the concurrent meetings of the Pension Fund Sub-committee together with the Pensions Board on 26 February 2020. The risk register incorporates a risk matrix to clearly demonstrate the Pension Funds current threats relative to the individual risks anticipated, and a summary and prioritisation of risks to indicate the descriptive risks ranking.

Risk awareness is embedded into the investment performance management process.

Some of the main risks identified in the last review of the risk register were as follow:

- The risk that administration performance measures and targets may no longer be appropriate for the Fund. The specific risk has been addressed by the regular review of performance measures.
- Changes in legislation and other regulatory frameworks, such as pooling and merging of LGPS schemes in Scotland, may impact adversely on the Fund in terms of funding levels and governance structures. The risk has been added in relation to the consultation that is on-going into the structure of the LGPS schemes in Scotland, the outcome of which is still unclear.
- Brexit risks potentially impacting the Fund's assets and liabilities, added due to the on-going uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020 and how this could impact on the Fund's investments.
- The outcome of the McCloud judgement and how it will impact on the future liabilities of the Fund. A level of uncertainty remains on how the UK Government will legislate on the remedial action to be taken by Pension Funds to compensate individuals for the difference in treatment since the pension reforms on the grounds of age discrimination.

The full risk register is available via the following link to the Council's website:

<https://www.orkney.gov.uk/Council/C/pension-fund-sub-committee.htm>

## Significant Governance Issues

The following issues were highlighted in the Audit Report for financial year 2018-2019:

- It was noted on the Audit Report that the performance measures used to monitor the performance of the administration of the Fund were set many years ago, with the risk that the measures and targets may no-longer be the most appropriate for the fund. A review of the administration performance standards was presented to the Pension Fund Sub-committee on 26 February 2020.
- It was noted in the Audit Report that the Pension Fund Supplement of the Local Government Overview, produced annually by Audit Scotland, was not currently reviewed by the Pension Fund Sub-committee, and it was recommended that the overview report supplement be reported at the earliest available opportunity. The Financial Overview – Scottish Local Government Pension Scheme was subsequently reported to the Pension Fund Sub-committee on 27 November 2019.

## Pension Fund Annual Report and Accounts 2019/2020

In addition to the points above, it is noted that the impact of the Covid-19 pandemic on the Pension Fund as at the reporting date of the 31 March 2020 was minimal in terms of the administration of the Pension Fund in that the lockdown only started on the 24 March 2020. The 2019-20 financial statements do however reflect a correction in the financial markets at that time which is reflected as a fall in the value of the fund's investments. This was however seen as an overreaction by the financial markets to the unprecedented level of restrictions imposed by respective governments across the developed world in an attempt to contain the spread of the Covid-19 virus, and while much uncertainty remains, most of this value has since returned to the Fund's investments. The 2020-21 financial statements will reflect the impact that the pandemic is continuing to have on the Pension Fund in that reporting period.

### Access to Information

Pension Fund Sub-committee papers, minutes and the Funds Annual Report and Accounts are available via the Council's website <https://www.orkney.gov.uk/>.

### Opinion

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

- The work of Internal Audit and the professional pensions and accountancy staff within the Council.
- The External Auditor's reports.
- 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.

The internal financial control environment was enhanced through the adoption of a Risk Register, Procedural Standing Orders and the establishment of a scheme of delegation for the Pension Fund Sub-committee and supported by the Pension Board.

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 2020.

Councillor James W Stockan

**Councillor James Stockan**  
Leader  
26 October 2020

John Mundell

**John W Mundell, OBE**  
Interim Chief Executive  
26 October 2020

## 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	Compliance and Comments
<b>1. Structure</b> <p>The management of the administration of benefits and strategic management of Fund assets clearly rests with the main committee established by the appointing Council.</p>	<p>Compliance in Full: Yes</p> <p>On 17 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 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.</p>
<p>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.</p>	<p>Compliance in Full: Yes</p> <p>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.</p>
<p>That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.</p>	<p>Compliance in Full: Yes</p> <p>The agreed terms of reference for operation of the PSC include the requirement to produce a formal minute of all meetings. The PSC sit at the same time as the PB allowing them to communicate with each other on the day they sit.</p>

<p>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.</p>	<p>Compliance in Full: Yes</p> <p>The PSC and PB sit at the same place and time to assist with 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.</p>
<p><b>2. Representation</b></p>	
<p>That all key stakeholders are afforded the opportunity to be represented within the Pensions Board. These include:</p> <ul style="list-style-type: none"> <li>• Employing authorities including non-scheme employers, e.g. admitted bodies;</li> <li>• Scheme members including deferred and pensioner scheme members</li> <li>• Where appropriate, independent professional observers, and</li> <li>• Expert advisors (on an ad-hoc basis).</li> </ul>	<p>Compliance in Full: Yes</p> <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>
<p>b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision-making process, with or without voting rights.</p>	<p>Compliance in Full: Yes</p> <p>In accordance with the terms of reference, all members of the PB and PSC are treated equally. The two bodies sit at the same time to facilitate equal opportunity.</p>
<p><b>3. Selection and Role of Lay Members</b></p>	
<p>a) That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.</p>	<p>Compliance in Full: Yes</p> <p>At the inaugural meeting of the Pension Fund 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. Induction training was provided to new members following the local elections in May 2017.</p>

b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	<p><b>Compliance in Full: Yes</b></p> <p>The declaration of Member's interests is a standard item on the agenda of the PSC and PB.</p>
<b>4. Voting</b>	
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.	<p><b>Compliance in Full: Yes</b></p> <p>Full voting rights are given to all members of the PSC.</p>
<b>5. Training/ Facility Time/ Expenses</b>	
a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	<p><b>Compliance in Full: Yes</b></p> <p>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. The training policy was approved in 2015/16, and is aligned to CIPFA's Knowledge and Skills Framework.</p>
b) That where such a policy exists it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	<p><b>Compliance in Full: Yes</b></p> <p>All members are treated equally under the training policy.</p>
c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	<p><b>Compliance in Full: Yes</b></p> <p>The Administering Authority of the Pension Fund Sub-committee and Pension Board has to date considered the training requirements of committee members collectively and provided training on that basis. A log has been established of all training provided to members and this is monitored and reported as appropriate.</p> <p>The annual training plan for 2019-20 was approved by the PSC at its meeting of 27 February 2019.</p>

<b>6. Meeting Frequency</b>	
a) That an administering authority's main committee or committees meet at least quarterly	Compliance in Full: Yes  The PSC and PB are scheduled to meet at least four times a year.
b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Compliance in Full: Yes  The PSC and PB are scheduled to meet at least four times a year.
c) That an administering authority that does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Compliance in Full: Yes  On 17 February 2015, the PSC agreed to establish a Pensions Board (PB), with representatives from Trade Unions and admitted bodies.
<b>7. Access</b>	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Compliance in Full: Yes  All members are treated equally.
<b>8. Scope</b>	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliance in Full: 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 Policy and Resources Committee of the Council.

<b>9. 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.	Compliance in Full: 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.



**Gareth Waterson, BAcc,  
CA Head of Finance**

26 October 2020



**Councillor James  
Stockan Leader**

26 October 2020



**John W Mundell, OBE  
Interim Chief Executive**

26 October 2020

## Annual Accounts 2019-2020

### Pension Fund Account

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

2018-2019 £'000		2019-2020 £'000	Notes
	<b>Dealings with members, employers and others directly involved in the scheme</b>		
10,126	Contributions Receivable	10,332	5
777	Transfers In	1,096	6
10,903		11,428	
(7,376)	Benefits Payable	(8,851)	5
(701)	Payments to and on account of leavers	(439)	7
(8,077)		(9,290)	
<b>2,826</b>	<b>Net additions from dealings with members</b>	<b>2,138</b>	
(1,709)	Management Costs	(2,071)	18
1,117	<b>Net additions including management expenses</b>	67	
	<b>Return on Investments</b>		
8,099	Investment Income	8,232	8
15,244	Profits/(losses) on disposal of investments and changes in the market value of investments	(22,289)	9,12
(146)	Taxes on Income	(132)	
<b>23,197</b>	<b>Net Return/(Loss) on Investments</b>	<b>(14,189)</b>	
<b>24,314</b>	<b>Net increase/(decrease) in the net assets available for benefits during the year</b>	<b>(14,122)</b>	
366,392	Opening Net Assets of the Scheme	390,706	
<b>390,706</b>	<b>Closing Net Assets of the Scheme</b>	<b>376,584</b>	

## Net Assets Statement as at 31 March 2020

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 2020.

31 March 2019 £'000		31 March 2020 £'000	Notes
	<b>Managed Funds</b>		
240,799	Equities	230,515	
42,009	Fixed Income	43,443	
101,099	Pooled Investment Vehicles	99,282	
6,482	Cash Equivalents	3,329	
390,389		376,569	<b>10</b>
	<b>Current Assets</b>		
3	Cash Balances	6	
286	Contributions due	71	
1,026	Current Debtors	1,139	
1,315		1,216	<b>16</b>
	<b>Current Liabilities</b>		
(998)	Current Creditors	(1,201)	<b>17</b>
317	<b>Net Current Assets/(Liabilities)</b>	15	
390,706	<b>Net Assets of the Scheme available to fund benefits at the year end</b>	376,584	

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 audited accounts were issued on 26 October 2020.

**Gareth Waterson, BAcc, CA**  
Head of Finance  
26 October 2020

## 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 2019-2020 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 to the Fund 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

Investment assets are included in the financial statements on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to the contractual acquisition of the asset. From this

date any gains or losses arising from changes in the fair value of the asset are recognised in the fund account.

The values of investments as shown in the net assets statement have been determined at a fair value in accordance with the requirements of the Code and IFRS 13 (see note 13). For the purposes of disclosing levels of fair value hierarchy, the fund has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures. Market values, which are assessed as follows:

- 3.3.1. Market quoted securities are valued at bid market prices on the final day of the accounting period.
- 3.3.2. Fixed interest securities are valued at a market value based on current yields.
- 3.3.3. Pooled investments, which comprise the fund manager's unit trusts and open-ended investment companies, are valued at closing bid prices where bid and offer prices are published, or closing single price where single price is published.
- 3.3.4. Unquoted equity/debt and infrastructure asset valuations are provided by fund administrators following independent validation.

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 Payroll and 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.

### **3.8. 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.

### **3.9 Contributions Income**

Normal contributions, both from the members and employers, are accounted for on an accrual basis.

Employers' augmentation contributions and pension strain costs are accounted for in the period in which the liability arises. Any amounts due in the year but unpaid will be classed as current financial assets.

### **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. Management Expenses**

Management expenses includes direct management fees from external fund managers appointed to manage a segregated portfolio(s) of investments, indirect management charges levied on pool funds, transactions costs and expenses associated with the administration and governance of the Fund.

### **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 2020 for which there is a significant risk of material adjustment in the forthcoming financial year are 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.
Unquoted Private Debt	Unquoted private debt investment are valued by the administrators of the specialist pooled Fund using various valuations techniques that require significant judgement in determining appropriate assumptions. In recognition that these investments are relatively illiquid and to ensure objectivity in the valuation process the results are then validated by independent administrators. Nevertheless, as these investments are not publicly listed there is a greater degree of subjectivity and estimation involved in the valuation process. Pooled Investment - Private Debt £6.549m - There is a risk that this investment maybe under or overstated in the accounts.

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

Change in assumptions at year ended 31 March 2020	Approximate % increase to Employer Liability	Approximate monetary amount £m
0.5% decrease in Real Discount Rate	11%	36,425
0.5% increase in the Salary Increase Rate	2%	6,050
0.5% increase in the Pension Increase Rate	9%	29,899

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

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. Three standards have been issued but not yet adopted:

- IFRS 16 Leases
- IAS 28 Investments in Associates and Joint Ventures.
- IAS 19 Employee Benefits: Plan amendment, curtailment or settlement.

We do not expect any of these to impact on the Pension Fund.

### **3.16. 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.

While much uncertainty still exists around the future of the Government's unprecedented measures to contain the spread of Covid-19, it is clear that the virus has proved more troublesome than originally envisaged to get under control, with the result that the duration of the current lockdown restrictions have had to be extended into June 2020.

Financial markets have however reacted positively to the actions being taken by respective Governments across the globe to contain the virus, with the result that much of the value lost to stocks and shares in Quarter 1 2020 was regained in May 2020 as investors found their appetite for risk again. As at 29 May 2020, the value of the Pension Fund investments stood at £430.1m, representing a gain in value of £53.7m or 14.3% since the 31 March 2020. The accounts have not been adjusted for these events which took place after the reporting period.

The recent announcement that plans for a phased relaxation in the lockdown restrictions were under active discussion by Government is also an indication that the reinfection numbers are finally moving in the right direction. This also follows a similar pattern experienced in other countries that are ahead of us in the curve.

Although it is likely that much of 2020 will be written off in terms of lost economic activity, better than expected manufacturing data has added to the view that the economy could recover relatively quickly from the pandemic driven slump, with for example, the Euro Zone economy showing signs that it is rebounding faster than expected. That said, it remains a concern that other countries have experienced a resurgence of infection rates following the easing of lockdown measures, so it will be vitally important to keep this under control.

The draft annual accounts were signed by the Head of Finance on 26 June 2020. Events taking place after the date of authorisation for issue 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.

#### **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 2020 was £353m (2019: £391m).

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**

<b>Year ended</b>	<b>31 March 2019 % p.a.</b>	<b>31 March 2020 % p.a.</b>
Inflation/Pensions Increase Rate	2.5%	1.9%
Salary Increase Rate	2.9%	2.2%
Discount Rate	2.4%	2.3%

Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 28.

#### **Longevity Assumptions**

	<b>Males</b>	<b>Females</b>
Current Pensioners	21.7 years	23.8 years
Future Pensioners*	23.3 years	26.2 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

	2018-2019			2019-2020		
	Orkney Islands Council £'000	Admitted Bodies £'000		Orkney Islands Council £'000	Admitted Bodies £'000	
Employee Contributions	2,252	278	2,530	2,384	291	2,675
Employer Contributions	6,703	775	7,478	6,854	788	7,642
Strain Costs	109	9	118	15	0	15
<b>Total</b>	<b>9,064</b>	<b>1,062</b>	<b>10,126</b>	<b>9,253</b>	<b>1,079</b>	<b>10,332</b>

## 6. Analysis of Benefits Payable

	2018-2019			2019-2020		
	Orkney Islands Council £'000	Admitted Bodies £'000		Orkney Islands Council £'000	Admitted Bodies £'000	
Pensions Paid	5,083	183	5,266	5,519	189	5,708
Dependants Pensions	403	18	421	436	21	457
Lump Sums Paid	1,255	25	1,280	2,368	76	2,444
Death Grants Paid	276	133	409	242	0	242
<b>Total</b>	<b>7,017</b>	<b>359</b>	<b>7,376</b>	<b>8,565</b>	<b>286</b>	<b>8,851</b>

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

## 7. Transfers In

Transfers in to the scheme during 2019-2020 were £1.1m (2018-2019: £0.8m). This represents the total of transfer values in respect of individual members joining the scheme.

## 8. Payments to and on Account of Leavers

2018-2019 £'000		2019-2020 £'000
(26)	Contributions Returned	(23)
(675)	Individual Transfers to other Schemes	(416)
0	State Scheme Premiums	0
<b>(701)</b>		<b>(439)</b>

## 9. Investment income

	2018-2019 £'000	2019-2020 £'000
<b><u>Equities</u></b>		
Equities UK	1,649	1,599
Equities Global	2,379	2,872
<b>Total Equities</b>	<b>4,028</b>	<b>4,471</b>
<b><u>Fixed Income</u></b>		
UK Bonds	522	541
Overseas Bonds	0	0
Index Linked	395	288
<b>Total Fixed Income</b>	<b>917</b>	<b>829</b>
<b>Pooled Investment Vehicle - Multi-Asset Growth</b>	<b>1,656</b>	<b>1,384</b>
<b>Pooled Investment Vehicle - Diversified Growth</b>	<b>1,484</b>	<b>1,306</b>
<b>Pooled Investment Vehicle - Private Debt</b>	<b>0</b>	<b>230</b>
<b>Interest on Cash and Deposits</b>	<b>14</b>	<b>12</b>
<b>Totals</b>	<b>8,099</b>	<b>8,232</b>

## 10. Change in the Market Value of Investments

	2018-2019 £'000	2019-2020 £'000
Realised	16,842	19,760
Unrealised	(1,598)	(42,049)
<b>Total</b>	<b>15,244</b>	<b>(22,289)</b>

## 11. Analysis of Investments

As at 31 March 2020 the market value of the assets under management is as follows:

	31 March 2019 £'000	31 March 2020 £'000
<b>Equities</b>		
UK		
Quoted	44,732	34,226
<b>Overseas</b>		
Quoted	196,067	196,289
<b>Total Equities</b>	<b>240,799</b>	<b>230,515</b>
<b>Fixed Income</b>		
UK Bonds	21,021	23,178
UK Government Gilts	20,988	20,265
<b>Total Fixed Income</b>	<b>42,009</b>	<b>43,443</b>
<b>Pooled Fund - Multi-Asset Growth</b>	<b>56,731</b>	<b>52,023</b>
<b>Pooled Fund - Diversified Growth</b>	<b>44,368</b>	<b>40,710</b>
<b>Pooled Fund - Private Debt</b>	<b>0</b>	<b>6,549</b>
<b>Cash and Deposits</b>	<b>6,482</b>	<b>3,329</b>
<b>Totals</b>	<b>390,389</b>	<b>376,569</b>

The following table provides an analysis of investments by fund manager:

	31 March 2019 £'000	31 March 2019 %	31 March 2020 £'000	31 March 2020 %
Baillie Gifford	390,389	100.0	370,020	98.3
Barings	0	0.0	6,549	1.7
<b>Totals</b>	<b>390,389</b>	<b>100.0</b>	<b>376,569</b>	<b>100.0</b>

## 12. Reconciliation of Movements in Investments

Investments decreased in value to £376.6m as at 31 March 2020 (31 March 2019: £390.4m) a movement of £13.8m.

During 2019-2020, sales of investments totalled £60.3m and purchases totalled £71.9m, including £22.7m and £6.9m respectively relating to the transitioning to the revised investment strategy. Transaction costs are included in the cost of purchases and sales proceeds.

The following individual investments exceed 5% of the total value of the net assets of the Pension Fund at 31 March 2020.

	2019 £'000	2020 £'000
Baillie Gifford & Company – (Multi Asset Growth)	56,731	52,023
Baillie Gifford & Company – (Diversified Growth Fund)	44,368	40,710
Baillie Gifford & Company – (Act Index-Linked Gilts)	20,988	0

### 13. Investment Transactions

2019-2020	Opening				Change	Closing
	Market	Purchases	Sales	in Market	Market	Value
	Value			Value	Value	
<b>Investment Assets</b>	0	0	0	0	0	0
<b>Managed Fund Investments</b>						
Equities	239,524	38,437	(36,215)	(12,293)	229,453	
UK Bonds	21,021	2,074	(1,379)	1,462	23,178	
Index Linked Bonds	0	21,487	0	(1,222)	20,265	
Pooled Investment – British Small Companies	1,275	17	0	(230)	1,062	
Pooled Investment - Private Equity	0	6,889	0	(340)	6,549	
Pooled Investment – Fixed Interest	20,988	288	(22,666)	1,390	0	
Pooled Investment – Multi-Asset Growth	56,731	1,384	0	(6,092)	52,023	
Pooled Investment – Diversified Growth	44,368	1,306	0	(4,964)	40,710	
<b>Total Transactions</b>	<b>383,907</b>	<b>71,882</b>	<b>(60,260)</b>	<b>(22,289)</b>	<b>373,240</b>	
<b>Cash Deposits</b>	<b>6,482</b>					<b>3,329</b>
<b>Internal Net Current Assets / (Liabilities)</b>	<b>317</b>					<b>15</b>
<b>Total</b>	<b>390,706</b>					<b>376,584</b>

2018-2019	Opening				Change	Closing
	Market	Purchases	Sales	in Market	Market	Value
	Value			Value	Value	
<b>Investment Assets</b>	0	0	0	0	0	0
<b>Managed Funds</b>						
Equities	218,502	41,220	(35,256)	15,058	239,524	
UK Bonds	20,272	21	(5)	733	21,021	
Pooled Investment – British Small Companies	1,382	0	0	(107)	1,275	
Pooled Investment – Fixed Interest	20,165	5,102	(4,223)	(56)	20,988	
Pooled Investment – Multi-Asset Growth	56,025	0	0	706	56,731	
Pooled Investment – Diversified Growth	43,974	1,484	0	(1,090)	44,368	
<b>Total Transactions</b>	<b>360,320</b>	<b>47,827</b>	<b>(39,484)</b>	<b>15,244</b>	<b>383,907</b>	
<b>Cash Deposits</b>	<b>5,466</b>					<b>6,482</b>
<b>Internal Net Current Assets / (Liabilities)</b>	<b>606</b>					<b>317</b>
<b>Total</b>	<b>366,392</b>					<b>390,706</b>

## **14.Fair Value Hierarchy**

Assets and liabilities have been classified into three levels, according to the quality and reliability of information used to determine fair value.

### **Level 1**

Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities, quoted bonds and quoted unit trusts.

### **Level 2**

Assets and liabilities at Level 2 are those where quoted market prices are not available, for example where an instrument is traded in a market that is not considered to be active or where valuation techniques are used to determine fair value based on observable data.

### **Level 3**

Assets and liabilities at Level 3 are those where at least one input that could have a significant effect on the instruments' valuation is not based on observable market data.

The fund manager uses various valuation techniques that require significant judgement in determining appropriate assumptions.

Valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of International Financial Reporting Standards and United States Generally Accepted Accounting Principles.

The following table provides an analysis of the financial assets of the Fund, grouped into Levels 1, 2 and 3, based on the level at which the fair value is observable.

<b>Fair Value Through Fund Account</b>	<b>31 March 2019 £000's</b>	<b>31 March 2020 £000's</b>
Level 1: Quoted Market Price	267,027	276,225
Level 2: Using Observable Inputs	123,362	93,795
Level 3: With Significant Unobservable Inputs	0	6,549
<b>Net Investment Assets</b>	<b>390,389</b>	<b>376,569</b>

### **Transfers Between Levels 1 and 2**

£20.3m of UK Government Gilts were transferred from Level 2 to Level 1 in March 2020 as a result of the movement of units away from pooled funds as part of the Fund's transitioning to the revised investment strategy. All transfers between levels are recognised in the month in which they occur.

### Reconciliation of Fair Value Measurements Within Level 3

The following table provides a reconciliation of fair value measurements within level 3.

	Market Value 01 April 2019 £000's	Transfers Into Level 3 £000's	Transfers Out Of Level 3 £000's	Purchases During the Year £000's	Sales During the Year £000's	Unrealised Gains/ (Losses) £000's	Realised Gains/ (Losses) £000's	Market Value 31 March 2020 £000's
Private Debt	0	0	0	6,889	0	(400)	60	6,549

### Basis of Valuation

The basis of valuation of each class is set out below. There have been no changes in the valuation techniques used during the year. All assets have been valued using fair value techniques which represents the highest and best price available at the reporting date.

Description of Asset	Valuation Hierarchy	Basis of Valuation	Observable and Unobservable Inputs	Key Sensitivities Affecting the Valuations Provided
Market Quoted Investments	Level 1	Published bid market prices ruling on the final day of the accounting period.	Not required	Not required
Quoted Bonds	Level 1	Fixed interest securities are valued at a market value on current yields.	Not required	Not required
Pooled Funds - Overseas Unit Trusts and Property Funds	Level 2	Closing bid price where bid and offer prices are published. Closing single price where single price is published.	NAV-based pricing set on a forward pricing basis	Not required
Unquoted Equity/Debt & Infrastructure	Level 3	Valuation provided by administrators to the Fund and are validated by independent administrators.	EBITDA with multiple discounts for lack of marketability control premium.	A degree of estimation is involved in the valuation. Material events, including movement in exchange rates and Covid-19.

### Sensitivity of Assets Valued at Level 3

Having analysed historical data, current market trends and consulted with independent advisors, the Fund has determined that the valuation methods described above are likely to be accurate to within the following ranges, and has set out the consequent potential impact on the closing value of investments held at 31 March 2020.

Asset Type	Assessed Valuation Range (+/-)	Value at 31 March 2020 £'000	Value on Increase £'000	Value on Decrease £'000
Private Debt (i)	7.2%	6,549	7,021	6,077

- i. The underlying assets are a series of privately originated loans. As such the valuations of these loans could move due to changes in a number of factors and assumptions including short term interest rates, inflation, the outlook for the profitability of the component companies and the likelihood of these companies to repay the loans. The potential movement of +/- 7.2% reflects the extent to which this value could vary based on each of these factors and assumptions.

### 15. Financial Instruments

Categories of Financial Instruments.

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

Financial Instruments Balances	31 March 2019 £'000	31 March 2020 £'000
<b>Investments</b>		
Financial Assets at fair value through profit/loss	383,907	373,240
Loans and receivables - cash and cash equivalents	6,482	3,329
<b>Total Investments</b>	<b>390,389</b>	<b>376,569</b>
<b>Current Assets and Liabilities</b>		
Debtors	1,315	1,216
Financial liabilities at amortised cost	(998)	(1,201)
<b>Total Current Assets and Liabilities</b>	<b>317</b>	<b>15</b>

### Income, Expenses, Gains and Losses

Financial Instruments Gains/Losses	31 March 2019	31 March 2020
	Financial Assets	
	£'000	£'000
Net gains/(losses) on financial assets at fair value through profit and loss	15,244	(22,289)
Investment Income	8,099	8,232
Investment management expenses including taxation	(1,855)	(2,203)
<b>Total Investment Gains and Losses</b>	<b>21,488</b>	<b>(16,260)</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 a Fair Value Hierarchy detailed at Note 13.

## 16. 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, revised investment strategy was approved in February 2020.

### 16.1. 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 (Hymans Robertson), 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	27.5
Global Equities	28.0
UK Index-Linked Gilts (long term)	9.3
UK Fixed Interest Gilts (medium term)	7.6
Diversified Growth	13.8
Private Debt	7.2
Cash	0.3
<b>Total Fund Volatility</b>	<b>18.9</b>

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 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	34,226	27.5%	43,638	24,814
Global Equities	196,289	28.0%	251,250	141,328
UK Index-Linked Gilts (long term)	20,265	9.3%	22,150	18,380
UK Fixed Interest Gilts (medium term)	23,178	7.6%	24,940	21,416
Diversified Growth and Multi Asset Growth	92,733	12.5%	104,325	81,141
Private Debt	6,549	7.2%	7,021	6,077
Cash	3,329	0.3%	3,339	3,319
<b>Total Fund Volatility</b>	<b>376,569</b>	<b>18.9%</b>	<b>447,741</b>	<b>305,397</b>

The total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

## 16.2 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 2020 and 31 March 2019 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

	31 March 2019 £'000	31 March 2020 £'000
Cash and cash equivalents	6,482	3,329

## 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 2020 £'000	Potential change in year in the net assets available to pay benefits	
		1% Interest Movement £'000	-1% Interest Movement £'000
Cash and Cash Equivalents	3,329	33.3	(33.3)
<b>Total Change in Assets Available</b>	<b>3,329</b>	<b>33.3</b>	<b>(33.3)</b>

### 16.3 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 both private debt and 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 2020:

Currency exposure - asset type	Asset value	Asset value
	31 March 2019 £'000	31 March 2020 £'000
Overseas Quoted Equities	193,178	192,106
Pooled Funds - Global Basket	2,889	10,733
<b>Total</b>	<b>196,067</b>	<b>202,839</b>

### Sensitivity analysis

Following analysis of historical data in consultation with Hymans Robertson, the council considers the likely volatility associated with foreign exchange movements to be 10%.

A 10% fluctuation is considered reasonable based on Hymans analysis of long-term historical movements. This analysis assumes that all other variables, in particular interest rates, remain constant.

A 10% strengthening/weakening of the pound against the various currencies in which the fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Assets exposed to currency risk	Asset values as at 31 March 2020	Potential % movement	Value on Increase	Value on Decrease
	£		£	£
Overseas Quoted Equities	192,106	10.0%	211,317	172,895
<b>Total Change in Assets Available to Pay Benefits</b>	<b>192,106</b>	<b>10.0%</b>	<b>211,317</b>	<b>172,895</b>

### 16.4 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 2020, including current account cash, was £0.006m. (31 March 2019: £0.003m). The Fund also held cash under its investment management arrangement. This was held with the following institutions:

	Rating (Fitch)	Balance 31 March 2020 £'000
<b>Bank current accounts</b>		
Royal Bank of Scotland	A+	6
<b>Cash held in Portfolio</b>		
Bank of New York Mellon (BNY)	AA	1,116

### 16.5 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 2020, the Fund had illiquid assets of £6.549m (2018-2019: £0.0m).

### 17. Current Assets

	31 March 2019 £000's	31 March 2020 £000's
Income Due	624	613
Recoverable Tax	313	360
Cash Balances	3	6
Transfer values receivable	89	129
Contributions due - Employers	210	51
Contributions due - Employees	76	20
Orkney Islands Council	0	0
Sundry Debtors	0	37
<b>Total Current Assets</b>	<b>1,315</b>	<b>1,216</b>

## 18. Current Liabilities

	31 March 2019 £'000's	31 March 2020 £'000's
Orkney Islands Council	619	626
Sundry Creditors	315	432
Transfer values payable	0	87
Benefits Payable	64	56
<b>Total Current Liabilities</b>	<b>998</b>	<b>1,201</b>

## 19. Management Expenses

	2018-2019 £'000	2019-2020 £'000
<b>Investment Management Expenses</b>		
Investment managers fees	1,189	1,408
Custodian fees	44	60
Other Investment management expenses	8	133
Stamp Duty	37	15
Other Transaction Taxes and Levies	11	17
Broker Commission	38	30
<b>Total Investment Management Expenses</b>	<b>1,327</b>	<b>1,663</b>
<b>Administration Costs</b>		
Staff time and Support allocations	286	309
<b>Total Administration Costs</b>	<b>286</b>	<b>309</b>
<b>Governance</b>		
Audit costs	21	21
Professional fees	75	78
<b>Total Governance Costs</b>	<b>96</b>	<b>99</b>
<b>Total</b>	<b>1,709</b>	<b>2,071</b>

## 20. Code of Transparency

The Code of Transparency enables a greater understanding of the investment process and better cost management through the fund managers disclosure of transaction costs.

Total transaction costs for each asset class are detailed below:

2019-2020	Transaction Taxes £	Broker Commission £	Implicit Costs £	Indirect Transaction Costs £	Total Transaction Costs £
Equities	31,837	29,829	31,189	0	92,855
Bonds	0	0	1,599	0	1,599
Pooled Funds	0	0	0	699,512	699,512
Foreign Exchange	0	0	3,058	0	3,058
<b>Total</b>	<b>31,837</b>	<b>29,829</b>	<b>35,846</b>	<b>699,512</b>	<b>797,024</b>

2018-2019	Transaction Taxes £	Broker Commission £	Implicit Costs £	Indirect Transaction Costs £	Total Transaction Costs £
Equities	47,613	38,029	18,934	0	104,576
Bonds	0	0	(18)	0	(18)
Pooled Funds	0	0	0	426,947	426,947
Foreign Exchange	0	0	2,049	0	2,049
<b>Total</b>	<b>47,613</b>	<b>38,029</b>	<b>20,965</b>	<b>426,947</b>	<b>533,554</b>

The nature of the transaction costs groups are as follows:

- Transaction Taxes – includes stamp duty and any other financial transaction taxes.
- Broker Commissions – payments for execution services, including exchange fees, settlement fees and clearing fees.
- Implicit Costs – indirect costs associated with buying and selling securities, being an estimate of market impact.
- Indirect Transaction Costs – transaction costs incurred within pooled funds when they buy and sell their underlying investments.

In addition to the transaction costs, the portfolio has incurred indirect fees of £255,831 (2018-2019: £250,946) paid from the Net Asset Value of the pooled funds.

## **21. Audit Fees**

In 2019-2020 the agreed audit fee for the year was £21,000 (2018-2019: £21,000).

## **22. Agency Arrangements**

The Orkney Islands Council Pension Fund pays discretionary pensions to former employees of Orkney Islands Council who were awarded compensatory added years in accordance with the Orkney Islands Council's Early Retirement and Severance Scheme, but subject to limitations set out in the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulation 1998. 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 £254k in 2019-2020 (2018-2019: £265k).

Members of The Fund who elected before 1 April 2008 to purchase added years of membership can continue to do so 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.

## **23. Statement of Investment Principles and Funding Strategy Statement**

The Council as Administering Authority approved its current Statement of Investment Principles in February 2020. 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 10 May 2018.

Both these documents are available on the Council website under the related download section [here](#), and are also available on request from the Council's Head of Finance.

## **24. Investment Management Arrangements**

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

From the 1 April 2017 the benchmark is a fund specific benchmark which means managed investment funds are measured against a range of indices reflecting the weighting or concentration of individual asset classes within the approved investment strategy. The target is to outperform the bespoke benchmark over rolling five-year periods.

## **25. Stock Lending**

In accordance with the Statement of Investment Principles 2020, stock lending is not permitted within any of its segregated investment mandates. As at 31 March 2020 no stock had been released to a third party under a stock lending arrangement.

## **26. Related Party Transactions**

Orkney Islands Council Pension Fund is administered by Orkney Islands Council. The Council incurred costs of £0.309m (2018-2019: £0.286m) 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 £6.87m to the fund in 2019-2020 (2018-2019: £6.81m). With the exception of the year end creditor balance shown at Note 17 all monies owing to and from the Fund were paid in the year.

The Fund had a balance due to Orkney Islands Council of £0.626m as at 31 March 2020 (The fund had a balance due to Orkney Islands Council of £0.619m as at 31 March 2019).

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 any financial or pecuniary interest related to specific matters on the agenda 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 2018-2019		Accrued pension 2019-2020	
	Pension £	Lump Sum £	Pension £	Lump Sum £
Chief Executive*	47,391	82,500	61,884	84,045
Head of Finance / Section 95 Officer	33,965	51,930	37,276	54,080

\*until 20 Nov 2019.

## **27. 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 will be automatically enrolled into the LGPS if they satisfy the automatic enrolment criteria, however they can opt in if they do not meet the automatic enrolment criteria.

A person employed by a community admission body or a person employed by a transferee admission body is eligible to 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.

Employees of community admission bodies and transferee admission bodies are also enrolled into the Local Government Pension Scheme if they satisfy the auto enrolment criteria.

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

<b>Membership Details at 31/03/2020</b>	<b>Active</b>	<b>Deferred</b>	<b>Pensioner</b>	<b>Dependant</b>
Orkney Islands Council	1,859	902	858	136
Orkney Islands Property Development	2	4	4	0
Pickaquoy Centre Trust	61	29	8	0
Orkney Enterprise	4	4	3	0
Orkney Tourist Board (Visit Scotland)	0	4	4	0
Orkney Ferries Limited	91	47	24	4
<b>Summary of Members</b>				
OIC	1,859	902	858	136
Admitted Bodies	158	88	43	4
<b>Totals</b>	<b>2,017</b>	<b>990</b>	<b>901</b>	<b>140</b>

## 28. 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.

## 29. Funding and Valuation Note

In line with the Local Government Pension Scheme (Scotland) Regulations 2014, 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 2017. The next valuation will take place as at 31 March 2020.

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 2017 actuarial valuation, the Fund was assessed as 112.7% funded (114.4% at the March 2014 valuation). This corresponded to a surplus of £38m (2014 valuation: surplus of £29m) at that time.

The assessed Primary contribution rate for 1 April 2018 – 31 March 2021 (i.e. the rate which employers in the Fund pay) at March 2017 was 20.7%, with applied Secondary contribution rates giving the required minimum contribution rates as follows:

2018/19: 18.2%

2019/20: 17.6%

2020/21: 17.0%

In accordance with the Funding Strategy Statement the administering authority has adopted employer contributions of 17.6% for 2019-2020. The valuation of the Fund has been undertaken using a ‘risk based’ approach which considers how each employer’s assets and liabilities may evolve over the future. The principal assumptions were:

## Financial Assumptions

Financial Assumptions	31-Mar-14	31 March 2017	
	Funding basis (% p.a.)	Funding basis (% p.a.)	Gilts basis (% p.a.)
Discount rate	5.10%	3.10%	1.40%
Price inflation	2.70%	2.40%	2.40%
Pay increases	4.50%	2.80%	2.80%
Pension increases:			
in excess of GMP	2.70%	2.40%	2.40%
post-88 GMP	2.70%	2.40%	2.40%
pre-88 GMP	0.00%	0.00%	0.00%
Revaluation of deferred pension	2.70%	2.40%	2.40%
Revaluation of accrued CARE pension	2.70%	2.40%	2.40%
Expenses	1.00%	0.70%	0.70%

\* 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 2017.

## 30. 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 £0.490m (2018-2019: £0.469m).

Members contributions are invested in a “with profits” Fund or a “deposit” Fund.

During the year the value of AVC investments increased by £0.216m to £3.127m as at 31 March 2020 (2019: £2.912m) excluding the final bonus.

## 30. Contingent Liabilities and Contractual Commitments

On 26 October 2018, The High Court ruled that Guaranteed Minimum Pensions (GMP) should be equalised between men and women to address the discrepancies in members' benefits arising from the contracting out of the additional state pension between 17 May 1990 and 6 April 1997. The Fund recognises the potential for liabilities arising from GMP equalisation however due to ongoing legal appeals and clarification of what has to be included it is not possible to quantify the impact this will have on the Fund at this time.

As at the 31 March 2020, as part of the transitioning arrangements to the revised investment strategy, the Fund had contractual commitments to invest up to £20m and £13.2m in each of the new mandates to Infrastructure Equity and Private Debt respectively. The drawdowns of these commitments are expected to take place over a period of three years and will be funded from within the Fund's portfolio of investments.

## **Independent Auditor's Report**

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

### **Report on the audit of the financial statements**

#### **Opinion on financial statements**

I certify that I have audited the financial statements in the annual report of Orkney Islands Council Pension Fund (the fund) for the year ended 31 March 2020 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and notes to the annual accounts, including a summary of significant accounting policies. 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 2019/20 (the 2019/20 Code).

In my opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2019/20 Code of the financial transactions of the fund during the year ended 31 March 2020 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 2019/20 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.

#### **Basis for opinion**

I conducted my audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. My responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of my report. I was appointed under arrangements approved by the Accounts Commission on 10 April 2017. The period of total uninterrupted appointment is four years. I am independent of the fund in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and I have fulfilled my other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the council. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

#### **Conclusions relating to going concern basis of accounting**

I have nothing to report in respect of the following matters in relation to which the ISAs (UK) require me to report to you where:

- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Head of Finance has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the fund's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

### **Risks of material misstatement**

I report in a separate Annual Audit Report, available from the [Audit Scotland Website](#), the most significant assessed risks of material misstatement that I identified and my conclusions thereon.

### **Responsibilities of the Head of Finance and Orkney Islands Council Pension Fund Sub Committee for the financial statements**

As explained more fully in the Statement of Responsibilities, the Head of Finance is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Head of Finance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Head of Finance is responsible for assessing the fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

The Orkney Islands Council Pension Fund Sub Committee is responsible for overseeing the financial reporting process.

### **Auditor's responsibilities for the audit of the financial statements**

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of my auditor's report.

### **Other information in the annual report**

The Head of Finance is responsible for the other information in the annual report. The other information comprises the information other than the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with my audit of the financial statements, my responsibility is to read all the other information in the annual report and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If I identify such material inconsistencies or apparent material misstatements, I am required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

### **Report on other requirements**

#### **Opinions on matters prescribed by the Accounts Commission**

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016); and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

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

I am required by the Accounts Commission 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.

I have nothing to report in respect of these matters.

### **Conclusions on wider scope responsibilities**

In addition to my responsibilities for the annual accounts, my conclusions on the wider scope responsibilities specified in the Code of Audit Practice, including those in respect of Best Value, are set out in my Annual Audit Report.

### **Use of my report**

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 120 of the Code of Audit Practice, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

*Gillian Woolman*

Gillian Woolman MA FCA CPFA  
Audit Director  
Audit Scotland  
4th Floor  
102 West Port  
Edinburgh  
EH3 9DN

26 October 2020

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 Ferries Limited
- Orkney Enterprise
- Pickaquoy Centre Trust
- Orkney Islands Property Development Limited

## Annex 2 – Actuarial Statement for 2019-2020

### 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 2018. 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 2018. 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.
- 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. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 66% chance that the Fund will return to full funding over 20 years.

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

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £335 million, were sufficient to meet 112.7% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2017 valuation was £38 million.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2018 to 31 March 2021 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 2017 valuation report.

#### **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 and inflation 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 2017 valuation were as follows:

Financial assumptions	31-Mar-17
Discount rate	3.1%
Pay increases	2.8%
Price inflation/Pension increases	2.4%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long-term rate of improvement of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.7 years	23.8 years
Future Pensioners*	23.3 years	26.2 years

\*Currently aged 45.

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from Orkney Islands Council, Administering Authority to the Fund.

### **Experience over the period since 31 March 2017**

Markets were disrupted by COVID 19 which resulted in difficult market conditions towards the end of the 2019/20 financial year. As a result, the funding level of the Fund as at 31 March 2020 has reduced versus that reported at the previous formal

## Pension Fund Annual Report and Accounts 2019/2020

valuation. The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.

### **Julie West FFA**

For and on behalf of Hymans Robertson LLP

May 2020

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

<https://www.orkney.gov.uk/Council/P/pension-fund-annual-reports.htm>, including the following documents:

- #### • Annual Report and Accounts

Auditors: Audit Scotland

# Fund Advisers

Actuaries: Hymans Robertson

Bankers: Royal Bank of Scotland

Investment Advisors: Hymans Robertson

**Investment Custodians:** Bank of New York Mellon

## Performance Measurement: Hymans Robertson

Additional Voluntary Contributions (AVC) Managers: Prudential

Investment Managers: Baillie Gifford & Co

Barings

## Contact Details

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

Bryan Hay                      Telephone: 01856 873535.              Extension: 2108.

Pensions Manager Email: [bryan.hay@orkney.gov.uk](mailto:bryan.hay@orkney.gov.uk)

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: <https://www.orkney.gov.uk/>.

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

Head of Finance Email: [gareth.waterson@orkney.gov.uk](mailto:gareth.waterson@orkney.gov.uk)

Corporate Finance Senior Manager Email: [colin.kemp@orkney.gov.uk](mailto:colin.kemp@orkney.gov.uk)