

ORKNEY
ISLANDS COUNCIL

**Annual Report and Accounts of
the Orkney Islands Council
Pension Fund 2016-2017**

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MANAGEMENT COMMENTARY BY THE HEAD OF FINANCE, CHIEF EXECUTIVE AND LEADER OF ORKNEY ISLANDS COUNCIL

Introduction

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2017.

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

This Annual Report has been produced to provide Elected Members, Employers, scheme members and other interested parties with information concerning the performance and administration of the fund in financial year 2016-17 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 time to try and understand the scale of benefits that they will receive when they retire - whether this is from the Local Government Pension Scheme itself or through other pension arrangements, such as the State Pension.

Overview of Fund Business

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

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

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

Review of the Year

Key Facts And Figures:

Value of the Fund at 31 March 2017 was £335.3 million (£265.9m at 31 March 2016).

An Operational and Investment Income Surplus of £69.3 million was generated on the activities of the fund (compared to £2.8m for the year ended 31 March 2016).

The Increase in the Value of the Fund has been achieved mainly through a surplus of contributions receivable (£10.9m) less benefits payable (£6.8m) and management expenses (£1.2m), investment net income (£5.9m) along with an increase in the market value of investments (£60.7m). This represents a year on year increase of 26.1%.

Performance of the Fund on a three year rolling average basis has been 12.1% p.a., giving a relative return above benchmark of 0.9%.

Fund membership increased by 116 to 3,663.

Employers contributed £7.6 million to the Fund (£7.9m to 31 March 2016).

Employees contributed £2.3 million (£2.2m to 31 March 2016).

Pension and other benefits paid out were £6.1 million (£6.1m to 31 March 2016).

Transfer values paid into the Fund because staff changed employers was £1.05 million (£1m to 31 March 2016).

Transfer values out of the Fund because staff changed employers was £0.8m (£0.5m to 31 March 2016)

Over the 12 months to 31 March 2017, the Pension Fund's investments returned a gain of 24.4% which was 3.0% ahead of the benchmark. The benchmark is based on a local authority pension scheme average performance. Returns from the Fund have also performed ahead of its benchmark over each of the previous 3, 5 and 10 year periods. The target is for the fund managers to outperform the benchmark by 1% over a rolling 5 year period.

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

The benchmark return of 21.4% generally reflects favourable market conditions for investors during the year. The 3% excess over benchmark is attributed to asset allocation out performance of 0.7% and stock selection out performance of 2.3%.

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

The positive stock selection value of 2.3% reflects that the Fund has outperformed its peers in terms of the specific stocks chosen within different asset classes.

The value of the fund has increased by £69.3m in the financial year and totalled £335.3m at 31 March 2017.

The change in value of the fund over any given period is a combination of the net money flows into or out of the Fund and any gain or loss on the capital value of its investments. During the year income into the fund from dividends and interest was £5.9m (2016: £6.1m). The fund was further enhanced by a surplus of member contributions receivable over pension payments and

management expenses of £3.1m (2016: £3.4m surplus) as well as a net capital gain increase of £60.7m (2016: £6.3m loss). Irrecoverable withholding tax reduced the value of the fund by £0.2m (2016: £0.4m).

The Accounts are based on the market value of investments at 31 March 2017. 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 2017 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 gain of £60.7m in the year, £35.2m (2016: £9.2m unrealised loss) was an unrealised gain and £25.5m (2016: £2.9m) realised profit.

Over the financial year the funding level has increased to 104% at 31 March 2017 from its value of 102% last financial year end, calculated on an ongoing funding basis. The primary cause of this increase is an excess return on assets, which has been partially offset by a decline in real bond yield, and subsequent discount rate, which places a higher value on the Fund's liabilities.

We are pleased to report that the Fund maintains a position above its 100% funding target, being in surplus by £13m at the financial year end (2016: £4m) according to the actuary's most recent funding update.

Investment Trends and Influences

For the year to 31st March 2017 the value of the Fund increased by 24.4%, performing well ahead of its benchmark which increased 21.4%. The benchmark is based on a local authority pension scheme average performance.

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

"Major equity and bond markets delivered positive returns over the 12 months to 31 March, buoyed by signs of economic growth in areas including the UK and US. Equities in particular performed well, most notably for sterling investors who benefitted from a weaker pound. This was despite periods of uncertainty, as the spotlight fell on political change in the West.

Throughout the period, the focus in the US was on the Presidential election campaign, culminating in Donald Trump's inauguration in January. The surprise election result saw equities, bond yields and the dollar all higher. In December, the US Federal Reserve announced that they would be raising rates for only the second time in a decade, from 0.5% to 0.75%. This was quickly followed by a second rise in March, reflecting the continued pick up in the US economy.

The main event in the UK was the vote to leave the EU. The result led to increased volatility in the immediate aftermath, but equity markets have subsequently performed well. The most notable impact has been on sterling which fell sharply following the result – reaching a 31-year low against the dollar – and has failed to show any significant recovery since. In August, the Bank of England announced measures to stimulate growth in the UK economy, including a cut in interest rates from 0.5% to a new record low of 0.25%. In March 2017 the government triggered Article 50, initiating the UK's formal withdrawal from the EU. This process is due to be completed in 2019.

There are, as always, plenty of important challenges facing investment markets in the months ahead. Not unreasonably, many people will be looking for the support of improving fundamentals to sustain the small increase in sentiment. The good news is that, in our view, the growth potential of the stocks in your Fund still offer the possibility of good returns over the coming years."

Following a review of the Fund's investment strategy the Pension Fund transitioned to a new benchmark in February 2017. This included reducing the weighting in UK equities, re-organising the fixed income holdings to be UK focussed and taking a new holding in the Baillie Gifford Multi Asset Growth Fund.

Investment Strategy

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

The revised asset allocation and range guidelines that were applied with effect from February 2017 are shown in the Asset Allocation table below together with the actual asset allocation at 31 March 2017.

Asset Class	Asset Allocation at 31/03/2017	Range Guideline	Local Authority Revised Benchmark
	%	%	%
UK Equities	11.1	10-55	20.0
Overseas Equities	47.6	25-55	42.0
Government Bonds	11.8	10-30	15.0
Alternative Investments	0.0	0-20	10.0
Property	0.0	0	8.0
Cash	2.8	0-10	2.0
Global Pooled - Diversified/Multi-Asset Growth	26.7	0-35	3.0
Total	100.0		100.0

The bulk of the Fund is held in growth-seeking assets rather than those considered to be more defensive. Direct holdings in equities accounted for 58.7%, with indirect holdings in Diversified Growth and Multi-Asset Growth pooled funds accounting for a further 26.7% of the Fund's portfolio as at 31 March 2017.

As a result of the revised investment strategy, approved by Council in October 2016, Pension Fund investments were restructured in February 2017, resulting in a new allocation being made to the Baillie Gifford Multi Asset Growth Fund.

As a result of its exposure to equities, the relative performance of the Fund against its benchmark can be volatile over the short term. However the fund continues to have a strong funding position together with a net contribution from its dealing with members which allows it to take a long term view across successive investment cycles.

The top 10 direct equity holdings within the fund at 31 March 2017 were:-

Company	Market Value of Holding £ m
Baillie Gifford Multi Asset Growth Fund C Acc*	49.5
Baillie Gifford Diversified Growth Fund C Acc*	39.9
Baillie Gifford Act Index-Linked Gilt Plus C Acc*	19.9
Amazon.com	7.5
Prudential	6.9
Royal Caribbean Cruises	5.8
Naspers	5.2
TSMC ADR	4.7
SAP	4.5
UK Treasury 4.25% 07/12/2049	4.0

* Capital Accumulated

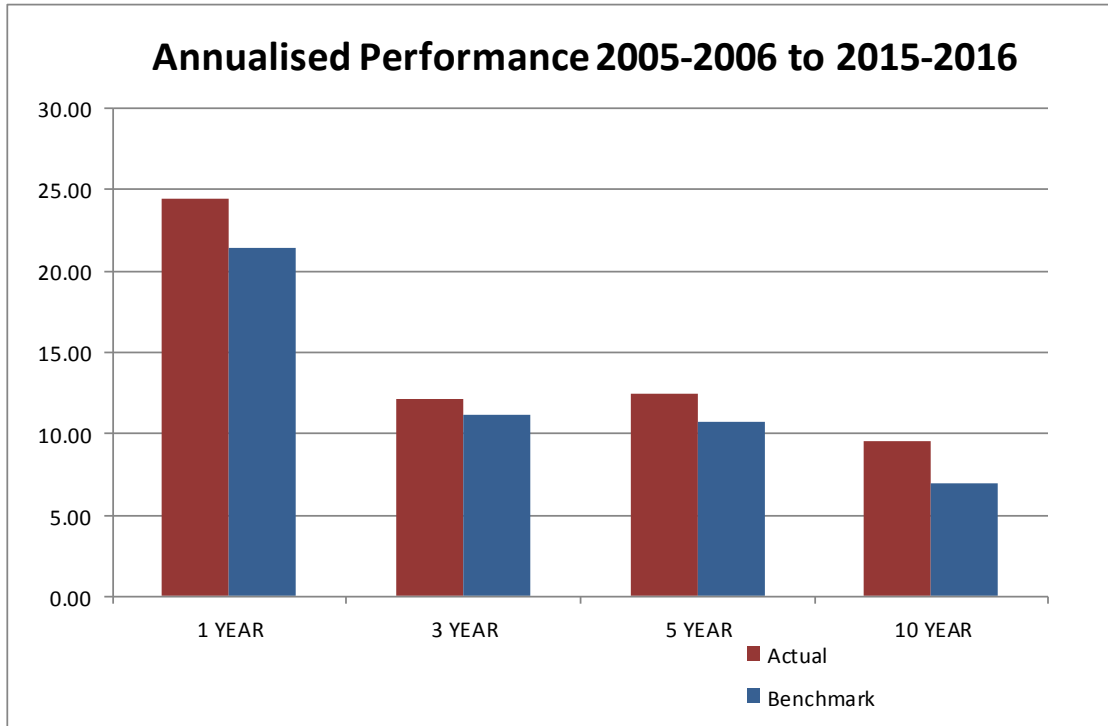
Investment Performance

The performance of the Pension Fund managed investment funds was previously measured against a peer group benchmark, the WM Local Authority Universe (excluding property) with assistance of the WM Company who were the Fund's appointed performance measurement advisors.

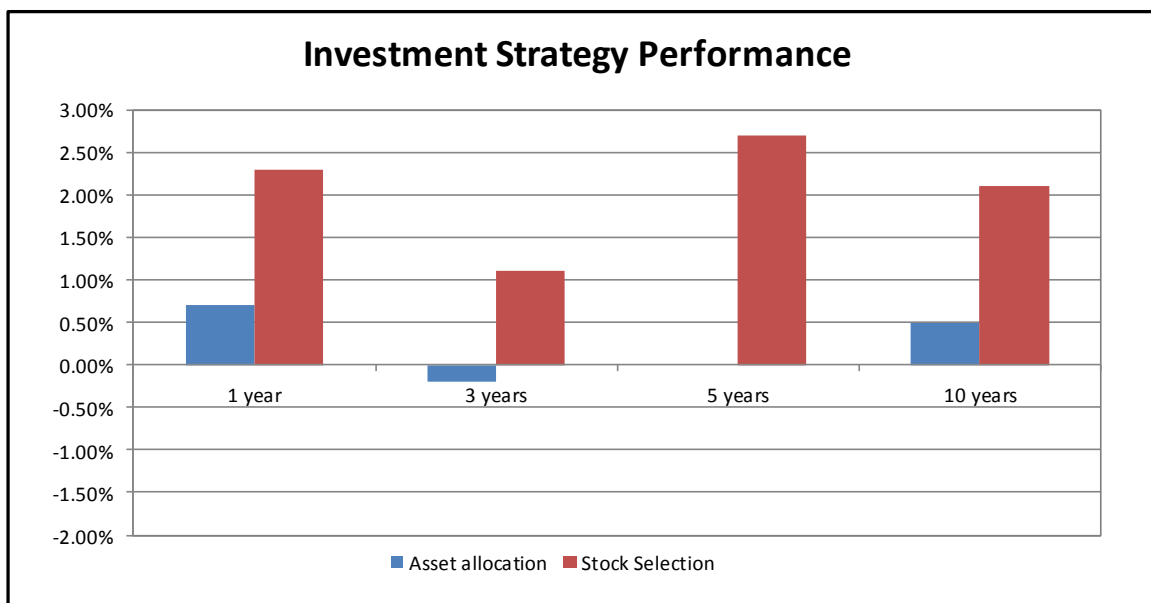
The WM Company ceased to provide the service with effect from 31 March 2016. With a fund specific benchmark being proposed as part of a revised investment strategy going forward, a change in approach was imminent. In the meantime, the services of Pensions and Investments Research Consultants Ltd (PIRC) have been engaged as a direct replacement to the WM Company, and to ensure continuity of the peer group benchmark for performance monitoring purposes in the interim. With effect from 1 April 2016, the performance monitoring of the Pension Fund is measured against the PIRC Local Authority Pension Fund Universe.

Baillie Gifford's revised performance target for this accounting period is to therefore outperform the PIRC Local Authority Pension Fund Universe benchmark by 1% p.a. when assessed over rolling 5 year periods. The average performance over the last 5 years of 12.5% remains well ahead of the benchmark of 10.7%.

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



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



Structure of Administration

Staffing

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

In addition to maintaining members’ records, the Pensions team also provide frontline services to Fund members. The Pension team deliver induction courses as well as answer calls, e-mails

and host meetings at the request of employees. Pre-retirement surgeries are arranged for members by Human Resources and the Performance team within Corporate Services.

The Pensions team consists of one full time Pensions Manager, a Senior Assistant and an Assistant. During 2015-2016, the size of the Pensions team was increased from 1.5 to 3.0 full time equivalents, including 0.5 temporary, in recognition of the additional workload associated with the implementation of the new Altair pensions administration system combined with the changes to the Scheme's regulations including auto enrolment and Career Average Revalued Earnings Scheme (CARE).

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

Systems

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

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

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

Administration Performance

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

Performance during financial year 2016-17 against the key service standards of the Pension Fund as set by the Council was as follows:

Category	Performance Standard – No of Working Days	Number of records processed within standard	Number of records processed Outwith standard	Percentage of records processed within standard	Prior Year Performance
Pension estimates	10	3	7	30.0%	35.4%
Retirement	3	66	5	93.0%	96.0%
Transfers In	10	47	6	88.7%	80.0%
Transfers Out	10	14	3	82.4%	55.6%
Refunds	3	18	0	100.0%	88.9%

Fund Update

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

Member Status	2015-2016	2016-2017
Contributing members	1,888	1,942
Pensioners	779	829
Deferred members	880	892
Total	3,547	3,663

Contributing Member	Someone who is currently employed by a scheduled or admitted body and is making contributions from pay to the Pension Scheme. Such a person is sometimes referred to as an “active” member.
Deferred Member	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.
Pensioner/Dependent Member	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 7 current and former employers during 2016-17. These include scheduled bodies, brought into the Fund by legislation, and admitted bodies, which chose to join the Fund. The detailed listing of employers and their membership numbers is contained in Note 22 of the Annual Report and Accounts for the Fund.

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 2016-17 which is prepared in line with the International Accounting Standard (IAS) 26 and supports the preparation of the Financial Statements for the Pension Fund.

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

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

be reduced to 19.8% during 2016-2017, with a minimum contribution rate of 19.2% in 2017-2018.

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

The most recent funding update produced at 31 March 2017 showed that the funding surplus has decreased since the last full valuation. Strong asset returns, partially offset against falling real bond yields has improved last year's funding level of 102%, to 104% at 31 March 2017.

Main Risks and Uncertainties facing the Fund

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

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

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

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

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

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

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

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

Future Developments

Career Average Revalued Earnings Scheme (CARE) – LGPS 2015

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

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

The main changes of this scheme are:

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

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

Development of the Pension Fund Sub-committee and Pensions Board

On 17 February 2015, the Council as Administering Authority agreed that a Pension Fund Sub-committee be established to fulfil the role of the Scheme Manager for the purposes of the Public Services Pensions Act 2013.

The establishment of a Pensions Board was also agreed at this time to assist the Scheme Manager in compliance with the Scheme Regulations. In accordance with the respective terms of reference, which were also agreed at the first meeting of the Pension Fund Sub-committee and Pension Board, the group have since met concurrently on four occasions during 2016-17.

Training activity for the members of the Pension Fund Sub-Committee and Pension Board was undertaken during the financial year 2016-17 to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively.

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
20 September 2017



Councillor James Stockan
Leader
20 September 2017



Alistair Buchan
Chief Executive
20 September 2017

STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

Responsibilities of the Orkney Islands Council as Administering Authority

The Council is required to:

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

I confirm that these Annual Accounts were approved for signature by the Pension Fund Subcommittee at its meeting on 20 September 2017.

Signed on behalf of Orkney Islands Council



Councillor James Stockan

Leader

20 September 2017

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 2017, and of its transactions for the year ended 31 March 2017.



Gareth Waterson, BAcc, CA
Head of Finance
20 September 2017

REMUNERATION REPORT

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

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

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

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

ANNUAL GOVERNANCE STATEMENT

Scope of Responsibility

Orkney Islands Council has statutory responsibility for the administration of the Local Government Pension Scheme (LGPS, both on its own behalf and in respect of 7 current and former employers. These include scheduled and admitted bodies.

As the administering authority for the Pension Fund, the Council is responsible for ensuring that its business, including that of the Pension Fund, is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

In discharging this overall responsibility, the Orkney Islands Council Pension Fund Sub-committee is responsible for putting in place proper arrangements for the governance of the Funds' affairs and facilitating the effective exercise of its functions, which 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 Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives (SOLACE) Framework: Delivering Good Governance in Local Government 2016.

Purpose of the Governance Statement

The governance framework comprises the systems and processes and culture and values by which Orkney Islands Council as the administering authority, and therefore the Pension Fund, is directed and controlled. It sets out the means by which the Pension Fund accounts to and engages with its stakeholders. It enables the Pension Fund to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of effective services.

The Orkney Islands Council Pension Fund is governed by the Local Government Pension Scheme (Scotland) Regulations. These include requirements for the preparation and production for a number of key policy documents including 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 in place to mitigate those risks.

The system of internal controls is a significant part of the governance framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness.

A governance framework has been in place at Orkney Islands Council and therefore the Orkney Islands Council Pension Fund for the year ended 31 March 2017 and up to the date of approval of the Annual Report and Accounts.

Governance Arrangements

1. This statement is given in respect of the Accounts of Orkney Islands Council Pension Fund. As Chief Executive and Leader of the Council as Administering Authority, we acknowledge our responsibility for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all governance matters, keeping proper administrative and financial records and accounts and maintaining an effective system of arrangements for governance control.

2. The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees, supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:
 - Comprehensive accounting systems that record income and expenditure for both member and investment activities,
 - Regular reviews of investment reports that measure investment returns against agreed benchmarks,
 - Regular reviews of investment manager reports that measure performance against agreed targets, and
 - Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.
3. The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
4. The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and its own independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

5. Administering Authority

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

6. Regulatory Framework

- 6.1 The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with guidance and regulations issued by the SPPA.
- 6.2 The Orkney Islands Council scheme is open to all employees of scheduled bodies except for those whose employment entitles them to belong to another statutory pension scheme (e.g. Teachers). Employees of admitted bodies can join the scheme subject to those bodies meeting the statutory requirements and on such terms and conditions as the Council (as Administering Authority) may require. A list of scheduled and admitted bodies is attached in Annex 1.
- 6.3 The Pension Fund Sub-committee (the Sub-committee) is a formal sub-committee of Orkney Islands Council's Policy and Resources Committee. The Scheme of Administration for the Council refers to the Pension Fund Sub-committee all matters relating to the management of investments of the Council's Pension Fund.

6.4 Financial affairs are conducted in compliance with the Council's Financial Regulations which were formally adopted by the Pension Fund in 2011.

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

7. Pension Fund Sub-committee and Pensions Board

7.1 The members of the Pensions Sub-committee together with the Pensions Board act as quasi-trustees and oversee the management of the Orkney Islands Council Pension Fund (the Fund).

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

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

7.4 The Sub-committee is comprised of the members of the Investments Sub-committee which itself is formed from seven members of the Council:

Leader (Chair of Policy and Resources Committee)

Deputy Leader (Vice Chair of Policy and Resources Committee)

Five other elected members of the Council

7.5 The Independent Investment Consultant, Head of Finance, Corporate Finance Senior Manager and Solicitor to the Council also attend the Sub-committee meetings as advisers.

7.6 The Sub-committee meets at least quarterly. Additional meetings are called as appropriate.

7.7 The Sub-committee papers and minutes are publicly available on the Council's website, unless they have been considered as private business in terms of Schedule 7A to the Local Government (Scotland) Act 1973. Minutes of the Sub-Committee are presented to the Policy and Resources Committee of the Council.

7.8 Membership of the Pension Board consists of equal numbers of trade union representatives and employer representatives, drawn from Orkney Islands Council and scheduled or admitted bodies in membership of the Pension Fund. Pension Board representatives may not also participate in or act as members of the Pension Fund sub-committee or the Monitoring and Audit Committee. Local Authority employer representatives will normally be Elected Members of the Council.

7.9 The Pension Board meets at least quarterly. A majority of either side may requisition a special meeting of the Pension Board in exceptional circumstances.

7.10 While the statutory roles and function of the Pension Fund Sub-committee and Pension Board are separate, the normal practice is that both bodies meet at the same time to consider the same agenda, with the Chair of the Pension Committee chairing the concurrent meeting. The Council's Standing Orders apply at concurrent meetings. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.

7.11 If the Pension Fund Sub-committee and Pension Board cannot reach joint agreement on any matter the process for resolving any differences between the two bodies is as follows. In the first instance, if at least half of the members of the Pension Board agree, then the Pension Board can refer back a decision of the Pension Fund Sub-committee

for further consideration if any of the defined grounds are met. Whilst this process is undertaken the decision of the Pension Fund Sub-committee is still competent.

- 7.12 If there is no agreement after the matter has been referred back to the Pension Fund Sub-committee, the decision of the Pension Fund Sub-committee stands and the difference in view between the Pension Board and the Pension Fund Sub-Committee will be published in the form of a joint secretarial report on the Pension Fund website and included in the Pension Fund annual report.
- 7.13 The Scottish LGPS Scheme Advisory Board may also consider and take a view on the matter and, if considered appropriate, provide advice to the Scheme Manager or the Pension Board in relation to the matter.

8 Administration and Financial Management of the Fund

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

9. Professional Advisers and External Service Providers

- 9.1 Hymans Robertson is appointed to act as Actuary to the Fund. The services provided include advice on investment strategy, funding level and actuarial valuations.
- 9.2 The Fund has appointed Baillie Gifford as investment manager who have responsibility for the selection, retention and realisation of individual investments. Where appropriate, they also implement the Sub-Committee's policy in relation to socially responsible investment and corporate governance.
- 9.3 Bank of New York Mellon is the global custodian for the Fund and is responsible for the safekeeping of the assets including transaction processing and making tax claims.
- 9.4 PIRC provides independent performance services for the Fund. They had responsibility for measuring and reporting on the performance of the Fund during the year.

10. Internal and External Controls and Review

- 10.1 The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation,

scheme of administration, committees and sub-committees. It is supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:

- Comprehensive accounting systems that record income and expenditure for both member and investment activities,
- Regular reviews of investment reports that measure investment returns against agreed benchmarks,
- Regular reviews of investment manager reports that measure performance against agreed targets, and
- Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.

- 10.2 The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
- 10.3 The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and the Orkney Islands Council's independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.
- 10.4 The Pensions Administrations Team consists of 3FTE, of which 0.5FTE is temporary.
- 10.5 The Head of Finance (Section 95 officer) for the Council as Administering Authority is responsible for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.
- 10.6 The Chief Internal Auditor (CIA) reports to the Monitoring and Audit Committee and functionally to the Executive Director of Corporate Services. She 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. For the year ended 31 March 2017, Internal Audit had planned to carry out an audit of the pension system migration. This work was not completed as sufficient progress had not been made with the data migration. Internal Audit instead undertook an audit of pension administration covering transactions occurring within 2016/17. The audit confirmed that there were robust systems and procedures in place with regard to the administration of the Council's pension scheme. 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.

11. Risk Management

- 11.1 The Fund's Risk Register was last reviewed and updated at the concurrent meeting on 18 February 2016 of the Pension Fund Sub-committee together with the Pensions Board.
- 11.2 Risk awareness is embedded into the investment performance management process.
- 11.3 Some of the main risks identified at the last review of the risk register were as follows:

- Failure to comply with all relevant LGPS (Scotland) Regulations, any changes and updates to the LGPS (Scotland) Regulations together with any overriding regulations. This risk is being monitored by several risk control measures including regular systems checks to ensure compliance with current and future defined LGPS (Scotland) Regulations; participation in the Investment Governance Group (IGG); and provision of staff training.
- The Fund's investments fail to deliver returns in line with the anticipated returns underpinning valuation of assets against liabilities over the long-term. This risk is being monitored by several risk control measures including the consideration of a navigator report annually to assess likely movements of assets and liabilities; strategy development discussed and review fully every 3 years by the PFSC; and the engagement of external investment advisers and actuaries to advise the PFSC on investment and funding strategy matters.

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

<http://www.orkney.gov.uk/Service-Directory/S/pension-fund-sub-committeepension-board.htm>

12. Significant Governance Issues

12.1 The migration of data and full implementation of the Altair system has taken longer than anticipated due to a number of issues including lack of capacity within the in-house staff team. During 15-16, in response to a request for additional staff to assist with the implementation of the project, the Pensions team was increased by the equivalent of 1.5FTE. However, since then staff shortages in the Payroll section necessitated a member of the Pensions team be redeployed to cover this shortage on a short-term basis. It has been agreed to increase the pace of migration as a priority to ensure that Altair system is fully operation in 2017/18.

13. Access to Information

13.1 Sub-committee papers and minutes are available via the Council website www.orkney.gov.uk.

13.2 The Fund's Annual Report and Accounts is available via the Council's website www.orkney.gov.uk.

14. Opinion

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

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

14.2 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 by the Pensions Board.

14.3 It is our opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal financial control systems during the year ended 31 March 2017.



Gareth Waterson, BAcc, CA
Head of Finance
20 September 2017



Councillor James Stockan
Leader
20 September 2017



Alistair Buchan
Chief Executive
20 September 2017

GOVERNANCE COMPLIANCE STATEMENT

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

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

Principle		Full Compliance	Comments
	of the main committee is allocated for a member from the secondary committee or panel.		The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.
Representation	a) That all key stakeholders are afforded the opportunity to be represented within the Pensions Board. These include: • Employing authorities including non-scheme employers, e.g. admitted bodies; • Scheme members including deferred and pensioner scheme members • Where appropriate, independent professional observers, and • Expert advisors (on an ad-hoc basis).	Yes	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. Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters.
	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.	Yes	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.
Selection and Role of Lay Members	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.	Yes	At the inaugural meeting of the Pensions Sub Committee and Pensions Board, held concurrently on 24 April 2015, respective Terms of Reference were duly approved for each body. In addition an induction programme has been provided to members. Induction training has been provided to new members following the local elections in May 2017.
	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.	Yes	The declaration of Member's interests is a standard item on the agenda of the PSC and PB.
Voting	The policy of individual administering authorities on voting rights is clear and	Yes	Full voting rights are given to all members of the PSC.

Principle		Full Compliance	Comments
	transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.		
Training/ Facility Time/ Expenses	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.	Yes	<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.</p> <p>There was training policy approved in 2015/16 which is aligned to CIPFA's Knowledge and Skills Framework. The training policy is due to go to committee for updating in 2017/18.</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.	Yes	All members are treated equally under the training policy.
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Yes	The Administering Authority of the newly formed Pension Fund Sub-committee and Pension Board has to date considered the training requirements of committee members collectively and provided training on that basis. A log has been established of all training provided to members and this is monitored and reported as appropriate. Further consideration will be given to the development of training plans in 2017.
Meeting Frequency	a) That an administering authority's main committee or committees meet at least quarterly	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	Yes	The PSC and PB are scheduled to meet at least four times a year.

Principle		Full Compliance	Comments
	least twice a year and is synchronised with the dates when the main committees sits.		
	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.	N/A	On 17 February 2015, the PSC agreed to establish a Pensions Board (PB), with Union, and admitted body membership.
Access	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.	Yes	All members are treated equally.
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The PSC deal with all matters relating to both the administration and investment of the Pension Fund. The PSC is formed from members of the Policy and Resources Committee of the council.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders, can express an interest in wanting to be part of those arrangements.	Yes	The Orkney Islands Council Pension Fund governance documents are available upon request. The Council as administering authority communicates regularly with employers and scheme members.

Gareth Waterson, BAcc, CA
Head of Finance
20 September 2017

Councillor James Stockan
Leader
20 September 2017

Alistair Buchan
Chief Executive
20 September 2017

ANNUAL ACCOUNTS 2016-17**Pension Fund Account**

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

2015-2016 £'000		2016-2017 £'000	Notes
	Dealings with members, employers and others directly involved in the scheme		
10,052	Contributions Receivable	9,872	5
998	Transfers In	1,048	6
11,050		10,920	
(6,105)	Benefits Payable	(6,049)	5
(470)	Payments to and on account of leavers	(771)	7
(6,575)		(6,820)	
4,475	Net additions/(withdrawals) from dealings with members	4,100	
(1,095)	Management Costs	(1,221)	15
3,380	Net additions/(withdrawals) including management expenses	2,879	
	Return on Investments		
6,091	Investment Income	5,871	8
(6,271)	Profits/(losses) on disposal of investments and changes in the market value of investments	60,730	9,12
(384)	Taxes on Income	(139)	
(564)	Net Return/(Loss) on Investments	66,462	
2,816	Net increase in the net assets available for benefits during the year	69,341	
263,133	Opening Net Assets of the Scheme	265,949	
265,949	Closing Net Assets of the Scheme	335,290	

Net Assets Statement as at 31 March 2017

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 2017.

31 March 2016 £'000		31 March 2017 £'000	Notes
	Investment Assets		
182,369	Equities	196,310	
	Managed Funds		
72,521	Pooled Investment Vehicles	128,899	
10,040	Cash Equivalents	9,400	
264,930		334,609	10
	Current Assets		
75	Cash Balances	66	
70	Contributions due from Employers	62	
1,396	Current Debtors	968	
1,541		1,096	13
	Current Liabilities		
(522)	Current Creditors	(415)	14
1,019	Net Current Assets/(Liabilities)	681	
265,949	Net Assets of the Scheme available to fund benefits at the year end	335,290	

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 20 September 2017.

Gareth Waterson, BAcc, CA
Head of Finance
20 September 2017

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 2016-17 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

3. Statement of Accounting Policies

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

3.1 Basis of Preparation

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

3.2 Transfers to and from other schemes

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

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

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

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

3.3 Financial Instruments

Investments

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

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

- 3.3.2 Overseas securities are valued at bid market prices from the relevant overseas stock exchanges converted at closing rates of exchange on the last day of the financial year.
- 3.3.3 Pooled investments, which comprise the fund manager's unit trusts and open ended investment companies, are valued at bid market prices on the last working day of the financial year as supplied by the fund manager.

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

3.4 Recognition of Income and Expenditure

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

- 3.4.1 Expenses in relation to services received (including services provided by Orkney Islands Council) are recorded as expenditure when the services are received rather than when payments are made.
- 3.4.2 Dividend income is recognised when the right to receive payment is established.
- 3.4.3 Where income and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Net Assets Statement.

3.5 Cash and Cash Equivalents

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

3.6 Administrative Overheads

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

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

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

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

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

3.8 Events after the Balance Sheet

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

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

The draft annual accounts were signed by the Head of Finance on 29 June 2017. Events taking place after this date have not been reflected in the financial statements. Material events between the balance sheet date and the date of signing have been considered and where necessary reflected in the financial statements.

3.9 Investment Income

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

3.10 Foreign Currency

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

3.11 Investment Management Expenses

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

3.12 Acquisition Cost

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

3.13 Critical Judgements in Applying Accounting Policies

Pension Fund liability

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

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

The Statement of Accounts contains estimated figures that are based on assumptions made by the Pension Fund about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current

trends and other relevant factors. However, because such factors cannot be determined with certainty, actual results could be materially different from the assumptions and estimate. The items in the financial statements at 31 March 2017 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.

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

Change in assumptions at year ended 31 March 2017	Approximate % increase to Employer Liability	Approximate monetary amount £m
0.5% decrease in Real Discount Rate	12%	41
0.5% increase in the Salary Increase Rate	4%	15
0.5% increase in the Pension Increase Rate	7%	24

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. This applies to the adoption of the following new or amended standards within the 2017/18 Code:

- Amendment to the reporting of transaction costs – 2017/18 Code
- Amendment to the reporting of investment concentration – 2017/18 Code

The Code requires implementation from 1 April 2017 and there is therefore no impact on the 2016/17 Fund Accounts.

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 2017 was £377m (2016: £281m).

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

Financial Assumptions

Year ended	31 March 2016 % p.a.	31 March 2017 % p.a.
Inflation/Pensions Increase Rate	2.2%	2.4%
Salary Increase Rate	4.2%	4.4%
Discount Rate	3.5%	2.6%

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

Longevity Assumptions

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

Future pensioners are assumed to be currently aged 45

Commutation assumption

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

5. Analysis of Contributions Receivable and Benefits Payable

Contributions Receivable

	2015-2016			2016-2017		
	Orkney Islands Council £000	Admitted Bodies £000		Orkney Islands Council £000	Admitted Bodies £000	
Employee Contributions	1,954	252	2,206	2,030	268	2,298
Employer Contributions	6,990	845	7,835	6,716	832	7,548
Strain Costs	11	-	11	26	-	26
Total	8,955	1,097	10,052	8,772	1,100	9,872

Benefits Payable

	2015-2016			2016-2017		
	Orkney Islands Council £000	Admitted Bodies £000		Orkney Islands Council £000	Admitted Bodies £000	
Pensions Paid	3,869	365	4,234	4,062	384	4,446
Dependants Pensions	324	28	352	350	28	378
Lump Sums Paid	1,109	104	1,213	925	142	1,067
Death Grants Paid	300	6	306	158	0	158
Total	5,602	503	6,105	5,495	554	6,049

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

6. Transfers In

Transfers in to the scheme during 2016-17 were £1.1m (2015-16: £0.998m). This represents the total of transfer values in respect of individual members joining the scheme.

7. Payments to and on Account of Leavers

2015-2016 £'000		2016-2017 £'000
(23)	Contributions Returned	(13)
(437)	Individual Transfers to other Schemes	(755)
(10)	State Scheme Premiums	(3)
(470)		(771)

8. Investment Income

	2015-2016 £'000	2016-2017 £'000
<u>Equities</u>		
Equities UK	2,341	1,809
Equities Global	<u>1,746</u>	<u>1,913</u>
Total Equities	4,087	3,722
<u>Fixed Income</u>		
UK Bonds	634	696
Overseas Bonds	463	514
Indexed Linked	<u>80</u>	<u>81</u>
Total Fixed Income	1,177	1,291
<u>Diversified Growth</u>		
Other	<u>807</u>	<u>836</u>
Total Diversified Growth	807	836
Total Cash and Deposits	<u>20</u>	<u>22</u>
Totals	6,091	5,871

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

2015-2016 £'000		2016-2017 £'000
2,910	Realised	25,487
(9,181)	Unrealised	35,243
(6,271)	Total	60,730

10. Analysis of Investments

As at 31 March 2017 the market value of the assets under management is as follows:

	31 March 2016	31 March 2017
Baillie Gifford	£'000	£'000
<u>Equities</u>		
Equities UK	59,439	35,939
Equities Global	122,930	159,041
Equities Small Companies	<u>2,380</u>	<u>1,330</u>
Total Equities	184,749	196,310
<u>Fixed Income - Pooled Investment Vehicles</u>		
UK Bonds	0	19,607
UK Corporate Bonds	12,495	0
UK Government Gilts	7,927	19,869
UK Government Gilts (Indexed Linked)	9,044	0
Overseas Bonds	9,489	0
Total Fixed Income	38,955	39,476
<u>Multi-Asset Growth</u>		
Other	<u>0</u>	<u>49,493</u>
Total Multi-Asset Growth	0	49,493
<u>Diversified Growth</u>		
Other	<u>31,186</u>	<u>39,930</u>
Total Diversified Growth	31,186	39,930
Total Cash and Deposits	<u>10,040</u>	<u>9,400</u>
Totals	264,930	334,609

All investments are publicly traded on recognised stock exchanges.

11. Reconciliation of Movements in Investments

Investments increased in value to £334.6m as at 31 March 2017 (31 March 2016: £264.9m) a movement of £69.7m.

During 2016-17, sales of investments totalled £34m and purchases totalled £64m. 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 2017.

	2016	2017
	£'000	£'000
Baillie Gifford & Company - (Multi Asset Growth)	-	49,493
Baillie Gifford & Company – (Diversified Growth Fund)	31,186	39,930
Baillie Gifford & Company – (Act Index-Linked Gilts)	-	19,869

12. Investment Transactions

2016-2017	Opening Market Value	Purchases	Sales	Change in Market Value	Closing Market Value
	£'000	£'000	£'000	£'000	£'000
Investment Assets					
Equities	182,370	26,636	(66,435)	52,409	194,980
UK Bonds	0	19,795	(654)	466	19,607
Managed Funds					
Pooled Investment – British Small Companies	2,380	39	(1,508)	419	1,330
Pooled Investment – Fixed Interest	38,954	9,589	(32,610)	3,936	19,869
Pooled Investment – Multi-Asset Growth		48,700	-	793	49,493
Pooled Investment – Diversified Growth	31,186	6,037	-	2,707	39,930
Managed Funds Subtotal	72,520	64,365	(34,118)	7,855	110,622
Total Transactions	254,890	110,796	(101,207)	60,730	325,209
Cash Deposits	10,040				9,400
Internal Net Current Assets / (Liabilities)	1,019				681
Total	265,949				335,290

2015-2016	Opening Market Value	Purchases	Sales	Change in Market Value	Closing Market Value
	£'000	£'000	£'000	£'000	£'000
Investment Assets					
Equities	189,215	23,836	(26,043)	(4,638)	182,370
Managed Funds					
Pooled Investment – British Small Companies	2,367	-	-	13	2,380
Pooled Investment – Fixed Interest	38,358	1,177	-	(581)	38,954
Pooled Investment – Diversified Growth	28,861	3,390	-	(1,065)	31,186
Managed Funds Subtotal	69,586	4,567	-	(1,633)	72,520
Total Transactions	258,801	28,403	(26,043)	(6,271)	254,890
Cash Deposits	2,716				10,040
Internal Net Current Assets / (Liabilities)	1,616				1,019
Total	263,133				265,949

13. Current Assets

	31 March 2016 £000's	31 March 2017 £000's
Income Due	604	540
Recoverable Tax	229	290
Cash Balances	75	66
Transfer values receivable	509	139
Contributions due from Employers	70	61
Orkney Islands Council	54	0
Total Current Assets	1,541	1,096

14. Current Liabilities

	31 March 2016 £000's	31 March 2017 £000's
Orkney Islands Council	-	49
Sundry Creditors	-	244
Transfer values payable	522	122
Total Current Liabilities	522	415

15. Management Costs

	2015-2016 £'000	2016-2017 £'000
Investment Management Expenses		
Investment managers fees	788	852
Custodian fees	28	32
Other Investment management expenses	6	4
Stamp Duty	43	50
Total Investment Management Expenses	865	938
Administration Costs		
Staff time and Support allocations	<u>159</u>	<u>238</u>
Total Administration Costs	159	238
Governance		
Audit costs	21	20
Professional fees	<u>50</u>	<u>25</u>
Total Governance Costs	71	45
Total	1,095	1,221

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

16. Audit Fees

In 2016-17 the agreed audit fee for the year was £20,000: (2015-16 £21,000).

17. Agency Arrangements

The Orkney Islands Council Pension Fund pays discretionary awards to former employees of Orkney Islands Council. The amounts paid are not included within the Fund Account but are provided as a service and fully reclaimed from the council. The total amount of these payments was £279k in 2016/17 and £285k in 2015/16.

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

18. Statement of Investment Principles and Funding Strategy Statement

The Council as Administering Authority approved its current Statement of Investment Principles in 2013. The Statement defines the Fund's operational framework insofar as investments are concerned. It is reviewed periodically to ensure that it continues to reflect the needs of the Fund and the views of its stakeholders. It is currently under review following implementation of a revised investment strategy in February 2017.

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

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

19. Investment Management Arrangements

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

From the 1 April 2016 the benchmark has been the PIRC Local Authority Pension Fund Universe. The target is to outperform the PIRC Local Authority Pension Fund Universe by 1% p.a. over rolling five year periods.

20. Stock Lending

In accordance with the Statement of Investment Principles 2013, stock lending is not permitted within any of its segregated investment mandates. As at 31 March 2017 no stock had been released to a third party under a stock lending arrangement.

21. Related Party Transactions

Orkney Islands Council Pension Fund is administered by Orkney Islands Council. The Council incurred costs of £0.238m (2015-16: £0.159m) 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 £6.72m to the fund in 2016-2017 (2015-16: £6.99m). With the exception of the year end debtor balance shown at Note 13 all monies owing to and from the Fund were paid in the year.

The Fund had a balance due to the Orkney Islands Council of £0.049m as at 31 March 2017 (The fund had a balance due from Orkney Islands Council of £0.054m as at 31 March 2016).

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

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

	Accrued pension 2015-2016		Accrued pension 2016-2017	
	Pension	Lump Sum	Pension	Lump Sum
	£	£	£	£
Chief Executive	39,067	79,247	41,740	80,171
Head of Finance / Section 95 Officer	27,165	49,917	28,749	50,008

22. Membership Details

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

Eligibility to join the scheme

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

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

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

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

Note 22 (Continued)

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

Membership Details at 31/03/2017	Active	Deferred	Pensioner	Dependant
Orkney Islands Council	1,776	796	677	98
Orkney Islands Property Development	2	5	3	0
Orkney Towage Company Limited	14	16	19	1
Pickaquoy Centre Trust	61	20	4	0
Orkney Enterprise	4	5	2	0
Orkney Tourist Board (Visit Scotland)	1	5	2	0
Orkney Ferries Limited	84	45	20	3
Summary of Members				
OIC	1,776	796	677	98
Admitted Bodies	166	96	50	4
Totals	1,942	892	727	102

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

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

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

The main changes of this scheme were:

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

24. Financial Instruments

Categories of Financial Instruments

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

Financial Instruments Balances	31 March 2016	31 March 2017
	£'000	£'000
Investments		
Financial Assets at fair value through profit/loss	254,890	325,209
Loans and receivables - cash and cash equivalents	10,040	9,400
Total investments	264,930	334,609
Current assets and liabilities		
Debtors	1,541	1,096
Financial liabilities at amortised cost	(522)	(415)
Total current assets and liabilities	1,019	681

Income, Expenses, Gains and Losses

Financial Instruments Gains/Losses	31 March 2016	31 March 2017
	Financial Assets	
	£'000	£'000
Net gains/(losses) on financial assets at fair value through profit and loss	(6,271)	60,730
Investment Income	6,091	5,872
Investment management expenses including taxation	(1,479)	(1,360)
Total investment gains and losses	(1,659)	65,242

Fair Values of Assets and Liabilities

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

25. Risk and Risk Management

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

25.1 Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix. The objective of the Funding Strategy is to identify,

manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

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

Sensitivity analysis

In consultation with the Fund's independent provider of performance and analytical data (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	15.8
Global Equities	18.4
UK Index-Linked Gilts (short term)	4.0
UK Index-Linked Gilts (medium term)	7.1
UK Index-Linked Gilts (long term)	9.0
UK Fixed Interest Gilts (short term)	3.2
UK Fixed Interest Gilts (medium term)	9.5
UK Fixed Interest Gilts (long term)	12.5
Diversified Growth	12.5
Cash	0.0
Total Fund volatility	11.9

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

			Potential change in year in the net assets available to pay benefits	
Asset Type	Value	% Change	Favourable Market	Unfavourable Market
			Movement	Movement
			£'000	£'000
UK Equities	35,939	15.8%	41,617	30,261
Global Equities	159,041	18.4%	188,305	129,777
UK Index-Linked Gilts (short term)	1,010	4.0%	1,050	970
UK Index-Linked Gilts (medium term)	5,047	7.1%	5,405	4,689
UK Index-Linked Gilts (long term)	15,142	9.0%	16,505	13,779
UK Fixed Interest Gilts (short term)	5,317	3.2%	5,487	5,147
UK Fixed Interest Gilts (medium term)	5,982	9.5%	6,550	5,414
UK Fixed Interest Gilts (long term)	8,308	12.5%	9,347	7,270
Diversified Growth and Multi-Asset Growth	89,423	12.5%	100,601	78,245
Cash	9,400	0.0%	9,400	9,400
Total Fund volatility	334,609	11.9%	374,427	294,791

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.

25.2 Interest rate risk

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

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

The Fund's direct exposure to interest rate movements as at 31 March 2017 and 31 March 2016 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

	31 March 2016	31 March 2017
	£'000	£'000
Cash and cash equivalents	10,040	9,400

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 2017	Potential change in year in the net assets available to pay benefits	
		1%	-1%
	£'000	£'000	£'000
Cash and Cash Equivalents	9,400	94.0	(94.0)

25.3 Currency exposure risk

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

The following table summarises the Fund's currency exposure at 31 March 2017:

Currency exposure - asset type	Asset value 31 March 2016	Asset value 31 March 2017
	£'000	£'000
Overseas Quoted Equities	118,824	155,623
Pooled Funds - Global Basket	4,106	3,418
Total	122,930	159,041

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 2017	Potential % movement	Value on Increase	Value on Decrease
	£		£	£
Overseas Quoted Equities	155,623	10.0%	171,185	140,061
Total change in assets available to pay benefits	155,623	0	171,185	140,061

25.4 Credit risk

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

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

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its treasury management arrangements at 31 March 2017, including current account cash, was £66k. (31 March 2016: £75k). The Fund also held cash under its investment management arrangement. This was held with the following institutions:

	Rating (Fitch)	Balance 31 March 2017
Bank current accounts		
Royal Bank of Scotland	BBB+	66
Cash held in Portfolio		
Handelsbanken	AA	2,050
Bank of New York Mellon (BNY)	AA	4,983
BNP Paribas Deposit	A+	2,000

25.5 Liquidity Risk

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

The Council has immediate access to its Pension Fund cash holdings.

The Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three months to convert into cash. As at 31 March 2017, the Fund had no illiquid assets.

26. Funding and Valuation Note

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

The key elements of the funding policy are:

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

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

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

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

Owing to volatility in the financial markets in the year following the actuarial review, it was decided to hold the pooled contribution rate at its previous level of 21.4% for 2015-2016 with a reduction in the rate to 19.8% in 2016-2017 and 19.2% in 2017-2018.

In accordance with the Funding Strategy Statement the administering authority has adopted employer contributions of 19.8% for 2016-2017. The valuation of the Fund has been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service. The principal assumptions were:

Financial Assumptions

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

* GMP = guaranteed minimum pension

Mortality assumptions

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

27. Additional Voluntary Contributions

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

During the year, member contributions amounted to £0.442m (2015-16: £0.370m).

Members contributions are invested in a "with profits" Fund or a "deposit" Fund. During the year the value of AVC investments increased by £0.236m to £2.818m as at 31 March 2017 (2016: £2.582m) excluding the final bonus.

28. Contingent Liabilities and Contractual Commitments

Following the Freedom and Choice provisions announced in the 2014 Budget, the Pension Fund has had an increase of enquiries from members about transferring benefits out of the LGPS. Illustrations provided to members indicate that at the year-end there are potential liabilities of £461k in respect of members who may exercise the option to take benefits out of the scheme.

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

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 approved by the Accounts Commission, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

I certify that I have audited the financial statements in the annual accounts of Orkney Islands Council Pension Fund for the year ended 31 March 2017 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 financial statements, 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 2016/17 (the 2016/17 Code).

In my opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the financial transactions of the fund during the year ended 31 March 2017 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 2016/17 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 of opinion

I conducted my audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). 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 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 Standards for Auditors, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the Head of Finance 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.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require me to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the fund and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Head of Finance; and the overall presentation of the financial statements.

My objectives are to achieve 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&I) 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.

Other information in the annual accounts

The Head of Finance is responsible for the other information in the annual accounts. 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 in accordance with ISAs (UK&I), my responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinions on other prescribed matters

I am required by the Accounts Commission to express an opinion on the following matters.

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 2014.

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.



Gillian Woolman MA FCA CPFA
Assistant Director
Audit Scotland
4th Floor
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Edinburgh
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20 September 2017

ANNEX 1 - Scheduled and Admitted Bodies

Orkney Islands Council Pension Fund

Scheduled Bodies

- Orkney Islands Council

Admitted Bodies

Active Admitted Bodies

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

ANNEX 2 – Actuarial Statement for 2016-2017

Orkney Islands Council Pension Fund (the Fund)

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

Description of Funding Policy

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

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

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

Funding Position as at the last formal funding valuation

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

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

Principal Actuarial Assumptions and Method used to value the liabilities

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

Method

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

Assumptions

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

The key financial assumptions adopted for the 2017 valuation were as follows:

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

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to the long term rate of 1.25%p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

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

*Currently aged 45

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

Experience over the period since April 2014

The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bonds yields have fallen sharply which places a higher value on liabilities. The effect of this will have been partially offset by strong asset returns. The overall impact on the funding position at 31 March 2017 is that funding levels have likely worsened since the last formal valuation. This excludes the impact of possible changes to funding assumptions for the 2017 formal valuation, and membership experience which will be measured as part of that valuation: these items may improve or worsen the funding position.

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

Barry McKay FFA

Fellow of the Institute and Faculty of Actuaries
 For and on behalf of Hymans Robertson LLP
 2 June 2017

Hymans Robertson LLP
 20 Waterloo Street, Glasgow G2 6DB

ANNEX 3 - Glossary of Terms

ACTIVE MANAGEMENT

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

ASSET ALLOCATION

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

BALANCED MANAGEMENT

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

GROWTH MANAGER

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

MANDATE

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

PASSIVE MANAGEMENT

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

POOLED FUND

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

RETURN

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

RISK

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

SEGREGATED FUND

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

SPECIALIST MANAGEMENT

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

VALUE MANAGER

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

VESTED/NON VESTED OBLIGATIONS

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

PENSION FUND STRAIN

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

OPERATING SURPLUS/DEFICIT

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

ADDITIONAL INFORMATION

Key Documents Online

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

- Annual Report and Accounts

Fund Advisers

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

Contact Details

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

Bryan Hay	Telephone 01856 873535	Ext 2108
Pensions Manager	E-mail 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: www.orkney.gov.uk.

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

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