



**ORKNEY**  
ISLANDS COUNCIL

# **Annual Report and Accounts of the Orkney Islands Council Pension Fund 2014-2015**



# Contents

Management Commentary by the Head of Finance, Chief Executive and Convener of Orkney Islands Council .....	4
Statement of Responsibilities for the Annual Accounts .....	14
Remuneration Report.....	16
Annual Governance Statement .....	17
Governance Compliance Statement.....	23
Annual Accounts 2014-2015 .....	28
Independent Auditor's Report .....	52
Annex 1 - Scheduled and Admitted Bodies .....	54
Annex 2 – Actuarial Statement for 2014/15.....	55
Additional Information .....	60

# **Management Commentary by the Head of Finance, Chief Executive and Convener of Orkney Islands Council**

## **Introduction**

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2015.

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 2014/15 and we hope you find its content useful.

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

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

## **Overview of Fund Business**

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

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

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

## Review of the Year

### Key Facts And Figures:

**Value of the Fund** at 31 March 2015 was £263.1million (£227.7m at 31 March 2014).

**An Operational and Investment Income Surplus** of £35.4 million was generated on the activities of the fund (compared to £22.4m for the restated year ended 31 March 2014).

**The Increase in the Value of the Fund** has been achieved mainly through a surplus of contributions over expenditure (£2.8m), investment net income (£5.6m) and increases in the market value of investments (£27.3m).

**Performance of the Fund** on a three year rolling average basis has been 13.6% p.a., giving a relative return above benchmark of 2.4%.

**Fund membership** increased by 183 to 3,396.

**Employers contributed** £7.3 million to the Fund (£6.9m to 31 March 2014).

**Employees contributed** £2.1 million (£2.0m to 31 March 2014).

**Pension and other benefits paid out** were £5.6 million (£5.3m to 31 March 2014).

**Net Transfer values paid into the Fund because staff changed employers** were (£0.017 million) (£0.304m to 31 March 2014).

We are pleased to report strong growth in the net assets of the Fund for the year to 31 March 2015. The Fund generating a return of 13.8% performing ahead of its benchmark of 13.0%. The benchmark being based on a local authority average performance. Returns from the Fund have also exceeded its benchmark over each of the previous 3, 5 and 10 year periods.

The return of 13.8% is substantially ahead of returns that were available on cash and also compares well to the consumer price index of 0.0%, wage rate growth of 1.9% and a 2.6% increase in the FTSE 100.

The Fund continues to be actively managed by investment managers Baillie Gifford.

The benchmark return of 13% generally reflects favourable market conditions for investors during the year. The 0.8% excess over benchmark is attributed to asset allocation under performance of -0.1% and stock selection out performance of 0.9%.

The negative asset allocation amount, albeit modest, reflects that the Fund performed less well in terms of its portfolio distribution amongst asset classes than average 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 0.9% 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 £35.4m in the financial year and totalled £263.1m at 31 March 2015.

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 £5.6m (2014: £4.9m) and net capital gains were £27.3m. (2014: £14.7m). The fund was further enhanced by a surplus of member contributions receivable over pension payment and management expenses of £2.8m (2014: £3.1m surplus). A significant change from last year's accounts has been the inclusion of Fund Management fees within Management expenses rather than being deducted as a cost against Returns on Investment. Irrecoverable withholding tax reduced the value of the fund by £0.325m (2014: £0.213m).

The Accounts are based on the market value of investments at 31 March 2015. 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 the 31 March 2015 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 £27.3m achieved in the year, £17.8m (2014: £7.1m) was unrealised profit and £9.5m (2014: £7.6m) realised profit.

Despite strong asset returns over the financial year the funding level dropped to 106% at 31 March 2015 from its value of 114% last financial year end, calculated on an ongoing funding basis. The primary cause of this decline is a decrease in real bond yields in the year which places a higher value on the Fund's liabilities.

We consider the growth in asset values throughout the financial year as a satisfactory performance. Despite the drop in the funding level calculated at March 2015 from its previous year comparison we are pleased to report that the Fund maintains a position above its 100% solvency target, being in surplus by £15m at the financial year end (2014: £29m) according to the actuary's most recent funding update.

## **Investment Trends and Influences**

During the 12 months to 31 March, most major investment markets delivered positive returns. This was partly due to increasing investor confidence, partly to signs of general improvement in the economic backdrop and a continuation of the exceptionally loose monetary policy that remained a feature in many developed countries for much of the period.

There were several flashpoints around the world and these situations created uncertainty in terms of global security, although most had a limited impact on investment markets. By contrast, a sharp fall in the oil price and the resulting weakness in the Russian currency were of greater concern to investors and caused an increase in market volatility. However, the falling oil price was beneficial for some countries, businesses such as airlines and cruise companies and consumers more generally.

In the US, despite occasional setbacks, confidence in the economic recovery continued to grow. The generally favourable mood prompted the Federal Reserve to reduce and then halt its bond buying programme. Economic data in the UK also suggested an improving environment, with the revised GDP figures for 2014 above forecast. This helped these stock

markets to reach record levels towards the end of the (financial) period. The volatility in markets also prompted periodic moves into areas perceived as less risky and this led to positive performance by bonds.

Although the investment environment is continuing to improve, our Fund investment managers have no doubt that further political and economic challenges lie ahead. However, our Fund investment manager is generally optimistic on the outlook for the global economy. Markets may be volatile in the coming months, but our fund manager continue to focus on identifying and investing in companies with excellent growth prospects over the longer term.

## 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 and can be viewed at [www.orkney.gov.uk](http://www.orkney.gov.uk).

The revised asset allocation and range guidelines that were applied with effect from 1 April 2011 are shown in the Asset Allocation table below together with the actual asset allocation at 31/3/2015.

<b>Asset Class</b>	<b>Asset Allocation at 31/03/2015</b>	<b>Range Guideline</b>	<b>Local Authority Revised Benchmark</b>
	<b>%</b>	<b>%</b>	<b>%</b>
UK Equities	24.5	20-50	23.4
Overseas Equities	48.8	25-55	36.9
Pooled Bonds and Indexed Linked	14.7	10-30	18.3
Global Pooled including UK	0	0-35	7.1
Alternative Investments	0	0-20	8.6
Cash	1	0-10	2.8
Pooled Multi-Asset Funds	11	0-35	2.9
<b>Total</b>	<b>100</b>		<b>100</b>

The bulk of the Fund is held in growth-seeking assets rather than those considered more stable. Direct holdings in equities accounted for 73.3% of the Funds portfolio as at 31<sup>st</sup> March 2015.

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 has a strong funding position of 106% and continues to have a net contribution from its dealing with members which allows it to take a long term view across successive investment cycles.

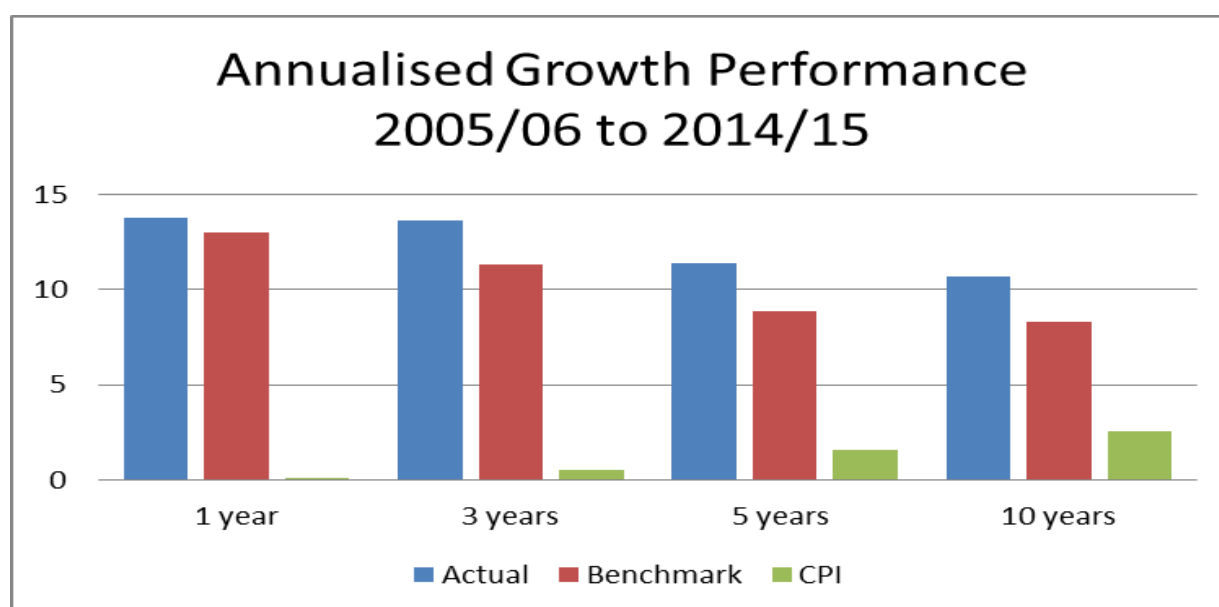
The top 10 direct equity holdings within the fund at 31 March 2015 were:-

Company	Market Value of Holding £ m
Prudential	7.1
Royal Caribbean Cruises	5.3
Naspers	5.2
TSMC ADR	3.2
Anthem Inc.	3.1
Amazon.com	3.0
Ryanair	2.9
TD Ameritrade Holding Corp	2.8
Markel	2.5
AIA Group	2.5

## Investment Performance

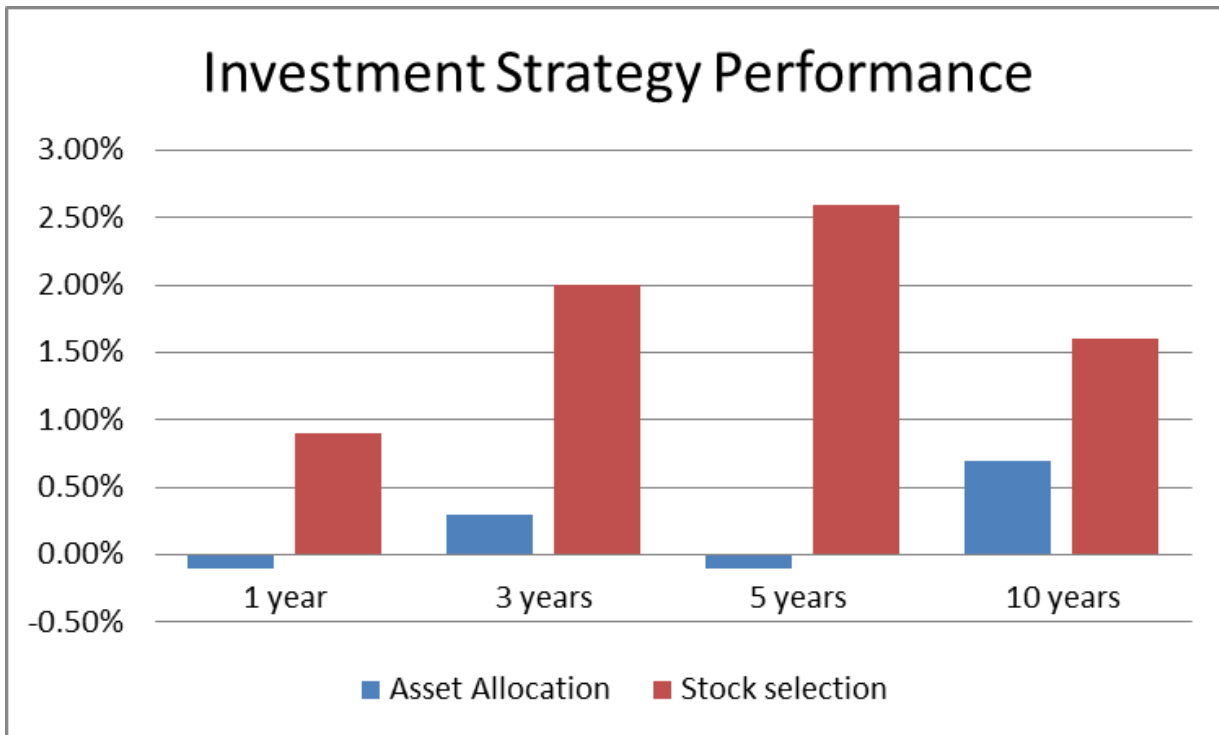
Baillie Gifford's performance target is to outperform the WM Performance Services (WM) Local Authority benchmark excluding property (re-balanced quarterly) by 1% p.a. when assessed over rolling 5 year periods, with effect from 1 July 2006. The average performance over the last 5 years of 11.4% remains significantly ahead of the performance target of 9.7% and benchmark of 8.7%. Baillie Gifford's asset allocation and stock selection is reviewed on a regular basis.

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 Corporate Services. The Pensions team is responsible for the maintenance of members’ records using data supplied by all employers in the Fund.

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

The Pensions team consists of one full time Pensions Manager and a Senior Assistant, staffing numbers are 2 employees although the full time equivalent is 1.5.

The above resources are supplemented by shared resources within Corporate Services which provides additional governance, investment and accounting expertise.

### Systems

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

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

The Council's Payroll system, NorthgateArinso is used to pay pensioner benefits. The Pensions team have viewing access to the payroll system, however amendments are made via a formal requests process to the Payroll team. Both the Pensions and Payroll teams are within Corporate Services and share the same Senior Administrator.

## 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 2014/15 against the key service standards of the Pension Fund as set by the Council was as follows:

<u>Category</u>	<u>Performance Standard – No of Working Days</u>	<u>Number of records processed within standard</u>	<u>Number of records processed Outwith standard</u>	<u>Percentage of records processed within standard (%)</u>	<u>Prior Year Performance (%)</u>
Pension estimates	10	27	25	51.92	20.59
Retirement	3	91	8	91.92	96.51
Transfers In	10	13	12	52.00	46.88
Transfers Out	10	11	2	84.62	83.33
Refunds	3	25	3	89.29	100.00

## Fund Update

### Membership Details

<b>Member Status</b>	<b>2013/14</b>	<b>2014/15</b>
Contributing members	1,685	1,781
Pensioners	700	758
Deferred members	828	857
<b>Total</b>	<b>3,213</b>	<b>3,396</b>

<b>Contributing Member</b>	Someone who is currently employed by a scheduled or admitted body and is making contributions from pay to the Pension Scheme. Such a person is sometimes referred to as an “active” member.
<b>Deferred Member</b>	Someone who was once a contributing member and who has chosen to leave his or her accumulated contributions in the Fund to benefit from a pension in due course.
<b>Pensioner/Dependant Member</b>	Someone who is receiving benefits from the Fund either as a former contributor or as a dependent of a former contributor who has deceased.

### **Employer Bodies**

The Fund invested and administered pensions on behalf of 10 current and former employers during 2014/15. These include scheduled bodies, brought into the Fund by legislation, and admitted bodies, which chose to join the Fund. The detailed listing of employers and their membership numbers is contained in Note 22 of the Annual Report and Accounts for the Fund (page 35).

### **Pension Increases**

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

### **Actuarial Valuation**

Annex 2 contains the formal Actuarial Statement for 2014/15 which is prepared in line with the International Accounting Standard (IAS) 26 and supports the preparation of the Financial Statements for the Pension Fund.

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

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

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

The most recent funding update produced at 31 March 2015 showed that the funding surplus has decreased since the last full valuation. Falling real bond yields were partially offset by strong asset returns and have resulted in a reduction from last year's funding level of 114% as per the triennial valuation, to 106% at 31 March 2015.

## **Main Risks and Uncertainties facing the Fund**

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

The Fund has its own risk register, which details some 33 risks faced by the fund and can be viewed at [www.orkney.gov.uk](http://www.orkney.gov.uk). An update on risk is a standing item at quarterly Pension Board and Pension sub- committee meetings.

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

**Financial Mismatch**, the risk that the Fund's assets fail to grow in line with the cost of meeting its liabilities. The Sub-committee measures and manages financial mismatch in several ways.

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

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

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

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

**Transition Risk**, the risk of incurring unexpected costs or losses when assets are transferred between fund assets. 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 are being 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:

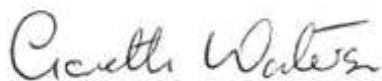
- A move towards benefits being worked out using career average revalued earnings rather than final salary;
- Pensions being built up at a rate of 1/49th of annual pensionable pay;
- Member's normal retirement age being linked to their own State Pension Age. Members may still be able to retire from age 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, Pensions Board and Investments Sub-committee**

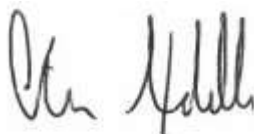
Training activity for the members of the Investments Sub-Committee was undertaken during the financial year 2014/15 to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively. On 17 February 2015, the Policy and Resources Committee agreed that the Investments Sub-committee continue in existence to fulfil its role in relation to non-pension fund matters and that a Pension Fund Sub-committee, comprising the same membership as the Investment Sub-committee, be established to fulfil the role of the Scheme Manager for the purposes of the Public Services Pensions Act 2013. The Policy and Resources Committee also agreed to the establishment of a Pensions Board, membership of which consists of four trade union representatives and four employer representatives

### **Acknowledgement**

We would like to take this opportunity to thank our colleagues in Corporate Services and the members of: the Investment Sub-Committee, 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  
18 September 2015



**Councillor Steven Heddle**  
Council Convener  
18 September 2015



**Alistair Buchan**  
Chief Executive  
18 September 2015

## **Statement of Responsibilities for the Annual Accounts**

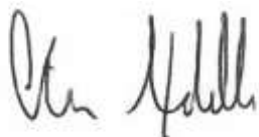
### **Responsibilities of the Orkney Islands Council as Administering Authority**

The Council is required to:

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

I confirm that these Annual Accounts were approved for signature at a meeting of the Pension Fund Sub Committee 18 September 2015.

**Signed on behalf of Orkney Islands Council**



**Councillor Steven Heddle**

Council Convenor  
18 September 2015

**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 2015, and of its transactions for the year ended 31 March 2015.



**Gareth Waterson, BAcc, CA**

Head of Finance  
18 September 2015

## **Remuneration Report**

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

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

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

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



# Annual Governance Statement

## Governance Arrangements

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

2. The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees, supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:

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

3. The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.

4. The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and its own independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

### 5.1 Administering Authority

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

5.2 The Council has delegated the management of the investment of the Pension Fund to the Pension Fund Sub-Committee.

5.3 The Council has established a Pension Board which is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.

## **6. Regulatory Framework**

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

6.2 The Orkney Islands Council scheme is open to all employees of scheduled bodies except for those whose employment entitles them to belong to another statutory pension scheme (e.g. Teachers). Employees of admitted bodies can join the scheme subject to those bodies meeting the statutory requirements and on such terms and conditions as the Council (as Administering Authority) may require. A list of scheduled and admitted bodies is attached in Annex 1.

6.3 The Pension Fund Sub-committee (the Sub-committee) is a formal sub-committee of Orkney Islands Council's Policy and Resources Committee. The Scheme of Administration for the Council refers to the Pension Fund Sub-committee all matters relating to the management of investments of the Council's Pension Fund.

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

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

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

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

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

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

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

Convener (Chair of Policy and Resources Committee)

Vice Convener (Vice Chair of Policy and Resources Committee)

Five other elected members of the Council

7.5 The Independent Investment Consultant, the Director of Corporate Services, Head of Finance, and Corporate Finance Senior Manager 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 Section within Corporate Services.

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 Corporate Services.

8.5 The annual financial statement of the Fund is subject to external audit. The auditors are appointed by Audit Scotland, as part of the process to ensure that public funds are properly safeguarded and accounted for.

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

9.1 Hymans Robertson is appointed to act as Actuary to the Fund. The services provided include advice on investment strategy, funding level and actuarial valuations.

9.2 The Fund has appointed Baillie Gifford as investment manager who have responsibility for the selection, retention and realisation of individual investments. Where appropriate, they also implement the Sub-Committee's policy in relation to corporate socially responsible investment and corporate governance.

9.3 Bank of New York Mellon is the global custodian for the Fund and is responsible for the safekeeping of the assets including transaction processing and making tax claims.

9.4 WM Performance Services provides independent performance services for the Fund. They have responsibility for measuring and reporting on the performance of the Fund.

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

10.1 The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees. It is supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:

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

10.2 The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.

10.3 The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and the Orkney Islands Council's independent internal audit

section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

10.4 During 2014/15 in response to recommendations in Audit Scotland's annual audit plan, budgets were put in place to enable better monitoring of administration performance of the Pension Fund.

10.5 The Head of Finance (Section 95 officer) for the council as Administering Authority is responsible for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.

10.6 The Chief Internal Auditor (CIA) reports to the Executive Director of Corporate Services and the Monitoring and Audit Committee and is in regular contact with the Head of Finance and Monitoring Officer. The CIA provides an independent and objective annual assurance statement on the effectiveness of internal control, risk management and governance based on the delivery of an approved plan of systematic and continuous internal audit review of the Council's arrangements. For the year ended 31 March 2015, Internal Audit did not carry out any specific work on the Pension Fund. However, given the structural size of Orkney Islands Council, there are common controls over council systems and pension systems. Internal audit's work on council systems provides management assurance that pension fund operations and transactions are appropriately controlled.

## **11. Risk Management**

11.1 The Fund has a Risk Register that was approved at the meeting on 24 April 2015 of the Pension Fund Sub-committee together with the Pensions Board.

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

## **12. Access to Information**

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

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

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

13.1 The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 require Administering Authorities to measure their governance arrangements set out against standards set by Scottish Ministers. These standards are established via a number of best practice principles. The Governance Compliance Statement details the Fund's status against these standards.

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

## 14. Opinion

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

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

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

14.3 It is our opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal financial control systems during the year ended 31 March 2015.



**Alistair Buchan**  
Chief Executive  
18 September 2015



**Councillor Steven Heddle**  
Council Convener  
18 September 2015

## 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 <sup>th</sup> February 2015, the Policy Resources Committee (PRC) established a Pension 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 ISC 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	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

Principle		Full Compliance	Comments
	across both levels.		sit at the same time as the PB allowing them to communicate with each other on the day they sit.
	That where a secondary committee or panel has been established; at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	<p>The PSC and PB sit at the same place and time to assist the formation of a consensus. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.</p> <p>Membership of the PSC will include all 7 elected members of the ISC.</p>
<b>Representation</b>	<p>a) That all key stakeholders are afforded the opportunity to be represented within the Pensions Board. These include:</p> <ul style="list-style-type: none"> <li>• Employing authorities including non-scheme employers, e.g. admitted bodies;</li> <li>• Scheme members including deferred and pensioner scheme members</li> <li>• Where appropriate, independent professional observers, and</li> <li>• Expert advisors (on an ad-hoc basis).</li> </ul>	Yes	<p>Members of the PSC are formed from the membership of the ISC who are selected from the membership of the Council.</p> <p>In accordance with the terms of reference for the operation of the PB, membership comprises 8 members; four trade union representatives and four employer representatives.</p> <p>Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters.</p>
	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	Yes	In accordance with the terms of reference, all members of the PB and PFC are treated equally. The two bodies sit at the same time to facilitate equal opportunity.



Principle		Full Compliance	Comments
	voting rights.		
<b>Selection and Role of Lay Members</b>	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.	Partial	At a meeting of the Pensions Sub Committee on 24 April 2015 the supporting Framework of the CIPFA Code of Practice for Public Sector Pensions Finance Knowledge and Skills, together with a Knowledge and Skills Framework to support the Code was adopted as the basis for training and development of members and officers involved in Pension Fund Financial matters.
	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.
<b>Voting</b>	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Full voting rights are given to all members of the PSC.
<b>Training/ Facility Time/ Expenses</b>	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	Members' training is funded from the Council's Pension Fund.
	b) That where such a policy exists it applies equally to all members of committees, sub-	Yes	All members are treated equally under the training policy.

Principle		Full Compliance	Comments
	committees, advisory panels or any other form of secondary forum.		
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	No	Annual training plans will be developed in the future. A log is maintained of all training provided to members and this is monitored and reported as appropriate.
<b>Meeting Frequency</b>	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 least twice a year and is synchronised with the dates when the main committees sits.	Yes	The PRC and PB are scheduled to meet at least four times a year.
	c) That an administering authority that does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Yes	On 17 February 2015, the PRC agreed to establish a Pensions Board (PB).
<b>Access</b>	That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	All members are treated equally.
<b>Scope</b>	That administering authorities have taken steps to bring wider scheme issues within the	Yes	The PSC deal with all matters relating to both the administration and investment of the Pension

<b>Principle</b>		<b>Full Compliance</b>	<b>Comments</b>
	scope of their governance arrangements.		Fund. The PSC is formed from members of the Investments Sub Committee of the council.
<b>Publicity</b>	That administering authorities have published details of their governance arrangements in such a way that stakeholders, can express an interest in wanting to be part of those arrangements.	Yes	The Orkney Islands Council Pension Fund governance documents are available upon request. The Council as administering authority communicates regularly with employers and scheme members.

## Annual Accounts 2014-2015

### Pension Fund Account

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

RESTATED	PRIOR YEAR ADJUSTMENT (note 3.7)	ORIGINAL			
2013/14 £'000	2013/14 £'000	2013/14 £'000		2014/15 £'000	Notes
			<b>Dealings with members, employers and others directly involved in the scheme</b>		
8,915		8,915	Contributions Receivable	9,373	<b>5</b>
492		492	Transfers In	288	<b>6</b>
9,407		9,407		9,661	
(5,313)		(5,313)	Benefits Payable	(5,597)	<b>5</b>
(188)		(188)	Payments to and on account of leavers	(305)	<b>7</b>
(837)		(837)	Management expenses	(923)	<b>15</b>
(6,338)		(6,338)		(6,825)	
<b>3,069</b>		<b>3,069</b>	<b>Net additions from dealings with members</b>	<b>2,836</b>	
4,856	72	4,784	<b>Return on Investments</b>		
			Investment Income	5,595	<b>8</b>
			Profits on disposal of investments and changes in the market value of investments	27,288	<b>9,12</b>
14,699		14,699	Taxes on Income	(325)	
(213)		(213)			
<b>19,342</b>	<b>72</b>	<b>19,270</b>	<b>Net Return on Investments</b>	<b>32,558</b>	
<b>22,411</b>	<b>72</b>	<b>22,339</b>	<b>Net increase in the net assets available for benefits during the year</b>	<b>35,394</b>	
205,328	640	204,688	Opening Net Assets of the Scheme	227,739	
<b>227,739</b>	<b>712</b>	<b>227,027</b>	<b>Closing Net Assets of the Scheme</b>	<b>263,133</b>	

## Net Assets Statement

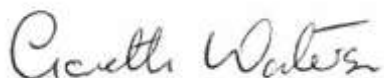
The Net Assets Statement sets out the value, as at the statement date, of all assets and current liabilities of the Fund. The net assets of the Fund (assets less current liabilities) represent the funds available to provide for pension benefits at the statement date.

As at 31 March 2015

RESTATED	PRIOR YEAR ADJUSTMENT (Note 3.7)	ORIGINAL			Notes
2013/14 £'000	2013/14 £'000	2013/14 £'000		2014/15 £'000	
163,201		163,201	<b>Investment Assets</b>	189,215	
			Equities		
61,062		61,062	<b>Managed Funds</b>	69,586	
3,010		3,010	Pooled Investment Vehicles	2,716	
			Cash Equivalents		
227,273		227,273		261,517	10
			<b>Current Assets &amp; Liabilities</b>		
693		693	Cash Balances	82	
62		62	Contributions due from Employers	55	
712	712	0	Current Debtors	1,696	13
(1,001)		(1,001)	Current Creditors	(217)	14
466	712	(246)		1,616	
<b>227,739</b>	<b>712</b>	<b>227,027</b>	<b>Net Assets of the Scheme available to fund benefits at the year end</b>	<b>263,133</b>	

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

The unaudited accounts were issued on 25 June 2015 and the audited accounts authorised for issue on 18 September 2015.



**Gareth Waterson, BAcc, CA**

Head of Finance

18 September 2015

## **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 is contracted out of the State Second Pension. 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 2014/15 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 received and paid 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 received/paid, 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 receipts 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 at market value, 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.

In 2015 in accordance with IAS 18 Revenue Recognition, the fund changed its accounting policy for investment income. Previously, the fund recognised dividend and interest income on a receipts basis. The fund now recognises investment income when the right to receive payment is established. This change in accounting policy is accounted for retrospectively, and the comparative information for 2014 is restated. The effect of the change is an increase of £72,000 in the net return on investments for the year ended 31 March 2014. Furthermore, opening net assets for 2014 are increased by £640,000, which is the amount of the adjustment relating to periods before 2014.

### **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.

### **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. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 26. This estimate is subject to significant variances based on changes to the underlying assumptions.

### **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 2015 for which there is a significant risk of material adjustment in the forthcoming financial year is as follows:-

<b>Item</b>	<b>Uncertainties</b>
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:

<b>Change in assumptions at year ended 31 March 2015:</b>	<b>Approximate % increase to Employer Liability</b>	<b>Approximate monetary amount (£000)</b>
0.5% decrease in Real Discount Rate	11%	30,286
1 year increase in member life expectancy	3%	8,238
0.5% increase in the Salary Increase Rate	4%	12,145
0.5% increase in the Pension Increase Rate	6%	17,303

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

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

- IFRS 13 fair value measurement
- Annual improvements to IFRS 2010 – 2012 cycle
- Annual improvements to IFRS 2011 – 2013 cycle.

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

### **4. Actuarial Present Value of Promised Retirement Benefits**

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

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

The actuarial present value of promised retirement benefits at 31 March 2015 was £296m (2014: £251m).

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

### Financial Assumptions

Year ended	31 Mar 2015 % p.a.	31 Mar 2014 % p.a.
Inflation/Pensions Increase Rate	2.4%	2.8%
Salary Increase Rate	4.3%	5.1%
Discount Rate	3.2%	4.3%

### 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 retirements 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 Payable and Receivable

	2013/14		2014/15	
	Benefits Payable	Contributions Receivable	Benefits Payable	Contributions Receivable
Orkney Islands Council	£'000 4,746	£'000 7,971	£'000 5,163	£'000 8,397
Admitted Bodies	567	944	434	976
<b>Total</b>	<b>5,313</b>	<b>8,915</b>	<b>5,597</b>	<b>9,373</b>

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

## Analysis of Contributions Payable by Employers and Members.

2013/14						2014/15				
Employers		Members		Total		Employers		Members		Total
*	**	*	**			*	**	*	**	
£'000	£'000	£'000	£'000	£'000		£'000	£'000	£'000	£'000	£'000
0	0	0	0	0						
6,106	720	1,788	224	8,838	Normal	6,533	752	1,863	225	9,373
77	0	0	0	77	Additional	0	0	0	0	0
<b>6,183</b>	<b>720</b>	<b>1,788</b>	<b>224</b>	<b>8,915</b>	<b>Total</b>	<b>6,533</b>	<b>752</b>	<b>1,863</b>	<b>225</b>	<b>9,373</b>

\* Administering Body – Orkney Islands Council

\*\* Admitted Bodies

### 6. Transfers In

Transfers in to the scheme during 2014/15 were £0.288m (2013/14: £0.492m). This represents the total of transfer values in respect of individual members joining the scheme.

### 7. Payments to and on Account of Leavers

2013/14 £'000		2014/15 £'000
(21)	Contributions Returned	(23)
(160)	Individual Transfers to other Schemes	(273)
(7)	State Scheme Premiums	(9)
<b>(188)</b>		<b>(305)</b>

### 8. Investment Income

	RESTATED 2013/14 £'000	2014/15 £'000
<b>Equities</b>		
Equities UK	1,618	1,984
Equities Global	<u>1,654</u>	<u>1,510</u>
<b>Total Equities</b>	<b>3,272</b>	<b>3,494</b>
<b>Fixed Income</b>		
UK Bonds	642	673
Overseas Bonds	153	519
Indexed Linked	<u>229</u>	<u>182</u>
<b>Total Fixed Income</b>	<b>1,024</b>	<b>1,374</b>
<b>Diversified Growth</b>		

Other	<u>568</u>	<u>714</u>
<b>Total Diversified Growth</b>	<b>568</b>	<b>714</b>
<b>Total Cash and Deposits</b>	<b>(8)</b>	<b>13</b>
<b>Totals</b>	<b>4,856</b>	<b>5,595</b>

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

2013/14 £'000		2014/15 £'000
7,623	Realised	9,542
7,076	Unrealised	17,746
<b>14,699</b>	<b>Total</b>	<b>27,288</b>

## 10. Analysis of Investments

As at 31 March 2015 the market value of the assets under management is as follows:

	RESTATED 2013/14 £'000	2014/15 £'000
<b>Baillie Gifford</b>		
<b><u>Equities</u></b>		
Equities UK	57,711	61,672
Equities Global	105,490	127,543
Equities Small Companies	<u>2,207</u>	<u>2,367</u>
<b>Total Equities</b>	<b>165,408</b>	<b>191,582</b>
<b><u>Fixed Income</u></b>		
UK Bonds	15,595	20,207
Overseas Bonds	9,260	10,473
Indexed Linked	<u>7,439</u>	<u>7,678</u>
<b>Total Fixed Income</b>	<b>32,294</b>	<b>38,358</b>
<b><u>Diversified Growth</u></b>		
Other	<u>26,561</u>	<u>28,861</u>
<b>Total Diversified Growth</b>	<b>26,561</b>	<b>28,861</b>
<b>Total Cash and Deposits</b>	<b>3,010</b>	<b>2,716</b>
<b>Totals</b>	<b>227,273</b>	<b>261,517</b>

All investments are publicly traded on recognised stock exchanges.

## 11. Reconciliation of Movements in Investments

Investments increased in value to £261.5m as at 31 March 2015 (31 March 2014:£227.3m) a movement of £34.2m.

During 2014/15, sales of investments totalled £28m and purchases totalled £35m. Transaction costs are included in the cost of purchases and sales proceeds.

The following individual investment exceed 5% of the total value of the net assets of the Pension Fund at 31 March 2015.

	2014 £'000	2015 £'000
Baillie Gifford & Company - (Diversified Growth Fund)	26,561	28,861

## 12. Investment Transactions

2014/15	Opening Market Value £'000	Purchases £'000	Sales £'000	Change in Market Value £'000	Closing Market Value £'000
<b>Investment Assets</b>					
Equities	163,201	30,072	(27,241)	23,183	189,215
<b>Managed Funds</b>					
Pooled Investment – British Small Companies	2,207	0	0	160	2,367
Pooled Investment – Fixed Interest	32,294	4,483	(778)	2,359	38,358
Pooled Investment – Diversified Growth	26,561	714	0	1,586	28,861
<b>Managed Funds Subtotal</b>	<b>61,062</b>	<b>5,197</b>	<b>(778)</b>	<b>4,105</b>	<b>69,586</b>
<b>Total Transactions</b>	<b>224,263</b>	<b>35,269</b>	<b>(28,019)</b>	<b>27,288</b>	<b>258,801</b>
<b>Cash Deposits</b>	<b>3,010</b>				<b>2,716</b>
<b>Internal Net Current Assets / (Liabilities)</b>	<b>466</b>				<b>1,616</b>
<b>Total</b>	<b>227,739</b>				<b>263,133</b>

RESTATED 2013/14	Opening Market Value £'000	Purchases £'000	Sales £'000	Change in Market Value £'000	Closing Market Value £'000
<b>Investment Assets</b>					
Equities	153,161	31,414	(37,965)	16,591	163,201
<b>Managed Funds</b>					
Pooled Investment – British Small Companies	2,096	240	(623)	494	2,207
Pooled Investment – Fixed Interest	25,031	11,358	(1,718)	(2,377)	32,294
Pooled Investments – Diversified Growth	19,078	7,492	0	(9)	26,561
<b>Managed Funds Subtotal</b>	<b>46,205</b>	<b>19,090</b>	<b>(2,341)</b>	<b>(1,892)</b>	<b>61,062</b>
<b>Total Transactions</b>	<b>199,366</b>	<b>50,504</b>	<b>(40,306)</b>	<b>14,699</b>	<b>224,263</b>
<b>Cash Deposits</b>	<b>5,061</b>				<b>3,010</b>
<b>Internal Net Current Assets</b>	<b>901</b>				<b>466</b>
<b>Total</b>	<b>205,328</b>				<b>227,739</b>

### 13. Current Debtors

	<b>Restated 2013/14 £000's</b>	<b>2014/15 £000's</b>
Income Due	547	652
Recoverable Tax	165	140
Orkney Islands Council	0	904
<b>Total Debtors</b>	<b>712</b>	<b>1,696</b>

### 14. Current Creditors

	<b>2013/14 £000's</b>	<b>2014/15 £000's</b>
Orkney Islands Council	541	0
Other entities and individuals external to general government	460	217
<b>Total Creditors</b>	<b>1,001</b>	<b>217</b>



## 15. Management Expenses

	2013/14 £'000	2014/15 £'000
<b>Investment Management Expenses</b>		
Investment managers fees	441	612
Custodian fees	24	26
Other Investment management expenses	5	11
Stamp Duties and other transaction taxes and levies	<u>47</u>	<u>46</u>
<b>Total Investment Management Expenses</b>	<b>517</b>	<b>695</b>
<b>Administration Costs</b>		
Staff time and Support allocations	<u>283</u>	<u>153</u>
<b>Total Administration Costs</b>	<b>283</b>	<b>153</b>
<b>Governance</b>		
Audit costs	21	23
Professional fees	<u>16</u>	<u>52</u>
<b>Total Governance Costs</b>	<b>37</b>	<b>75</b>
<b>Total</b>	<b>837</b>	<b>923</b>

## 16. Audit Remuneration

In 2014/15 the agreed audit fee for the year was £22,970: (2013/14 £21,000).

## 17. Agency Arrangements

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

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

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

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

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

## **19. Investment Management Arrangements**

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

From the 1 July 2006 the benchmark has been the WM Local Authority Average. The target is to outperform the WM Local Authority (excluding Property) Universe by 1.2% 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 2015 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 £0.153m (2013/14: £0.283m) 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 £6.5m to the fund in 2014/15 (2013/14: £6.1m). With exception of the year end debtor balance shown at note 13 all monies owing to and from the Fund were paid in the year.

The Fund had a balance due from the Orkney Islands Council of £0.904m as at 31 March 2015 (The fund had a balance due to Orkney Islands Council of £0.541m as at 31 March 2014).

The members of the pension's sub-committee are active members of the Pension Fund. 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 benefits		Accrued pension benefits	
	2013/14		2014/15	
	Pension £	Lump Sum £	Pension £	Lump Sum £
Chief Executive	34,287	77,255	36,443	78,185
Executive Director of Corporate Services	33,487	79,197	35,249	79,979
Head of Finance / Section 95 Officer	23,034	48,050	24,827	48,815

## 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.

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

<b>Membership Details at 31/03/2015</b>	<b>Active</b>	<b>Deferred</b>	<b>Pensioner</b>	<b>Dependant</b>
Orkney Islands Council	1,659	753	601	109
Orkney Islands Property Development	2	6	1	0
Weyland Farms Limited	0	3	1	0
Orkney Towage Company Limited	14	18	17	1
Pickaquooy Centre Trust	29	19	4	0
Orkney Enterprise	5	4	2	0
Orkney Tourist Board	1	5	2	0
Orkney Ferries Limited	71	46	17	2
D & H Glue	0	2	1	0
Golder Landscapes	0	1	0	0
<b>Summary of Members</b>				
OIC	1,659	753	601	109
Admitted Bodies	122	104	45	3
<b>Totals</b>	<b>1,781</b>	<b>857</b>	<b>646</b>	<b>112</b>

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

The following admitted entities had no active members and were deemed to have cessation dates from the Fund at 1 April 2015: Weyland farms Limited, D&H Glue, and Golder Landscapes.

### **23. Scheme Arrangements**

The LGPS scheme applicable for 2014/15 came into force from 1 April 2009. It remained a final salary scheme but there were a number of changes to the benefits package from the previous scheme including:

- A change in the accrual rate from 1/80th pension plus 3/80th lump sum to an improved accrual rate of 1/60th for membership from 1 April 2009
- Choice of improved lump sum at retirement

- Introduction of dependant partner's pension
- Increased death in service cover
- Increased flexible retirement options
- Tiered contributions

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.

## 24. Financial Instruments

### Categories of Financial Instruments

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

<b>Financial Instruments Balances</b>	<b>2013/14</b>	<b>2014/15</b>
	<b>£'000</b>	<b>£'000</b>
<b>Investments</b>		
Financial Assets at fair value through profit/loss	224,263	258,801
Loans and receivables - cash and cash equivalents	3,010	2,716
<b>Total investments</b>	<b>227,273</b>	<b>261,517</b>
<b>Current assets and liabilities</b>		
Debtor to Loans Fund	712	792
Loans and receivables - cash and cash equivalents	755	1,041
Financial liabilities at amortised cost	(1,001)	(217)
<b>Total current assets and liabilities</b>	<b>466</b>	<b>1,616</b>

## Income, Expenses, Gains and Losses

<b>Financial Instruments Gains/Losses</b>	<b>2013/14</b>	<b>2014/15</b>
	<b>Financial Assets</b>	
	<b>£'000</b>	<b>£'000</b>
Net gains/losses on financial assets at fair value through profit and loss	14,699	27,288
Investment Income	4,856	5,595
Investment management expenses including taxation	(730)	(1,020)
<b>Total investment gains and losses</b>	<b>18,825</b>	<b>31,863</b>

### Fair Values of Assets and Liabilities

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

### 25. Risk and Risk Management

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

#### 25.1 Market risk

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

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

## Sensitivity analysis

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

<b>Asset Type</b>	<b>Potential Market Movement +/- (%p.a.)</b>
UK Equities	11.69
Global Equities	10.27
Bonds & Index Linked	8.08
Cash	0.01
Diversified Growth	4.66

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:

			<b>Potential change in year in the net assets available to pay benefits</b>	
<b>Asset Type</b>	<b>Value</b>	<b>% Change</b>	<b>Favourable Market Movement</b>	<b>Unfavourable Market Movement</b>
	<b>£'000</b>		<b>£'000</b>	<b>£'000</b>
	127,54			
UK Equities	4	11.69%	142,454	112,634
Global Equities	61,672	10.27%	68,006	55,338
Bonds & index Linked	40,724	8.08%	44,014	37,434
Cash	2,716	0.01%	2,716	2,716
Diversified Growth	28,861	4.66%	30,206	27,516
<b>Total Assets</b>	<b>261,517</b>		<b>287,396</b>	<b>235,638</b>

### 25.2 Interest rate risk

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

The Fund's interest rate risk is routinely monitored by the Council and its Investment consultants, 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 2015 and 31 March 2014 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

	<b>2013/14</b>	<b>2014/15</b>

	<b>£'000</b>	<b>£'000</b>
Cash and cash equivalents	3,010	2,716

### 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 2015	Potential change in year in the net assets available to pay benefits	
		+1%	-1%
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Cash and Cash Equivalents	2,716	27	(27)
<b>Total change in assets available</b>	<b>2,716</b>	<b>27</b>	<b>(27)</b>

### 25.3 Currency exposure risk

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

The following table summarises the Fund's currency exposure at 31 March 2015:

Currency exposure - asset type	Asset value 2013/14	Asset value 2014/15
	£'000	£'000
Overseas Quoted Equities	102,421	124,513
Pooled Funds - Global Basket	3,069	3,030
<b>Total</b>	<b>105,490</b>	<b>127,543</b>

### Sensitivity analysis

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

**by currency**

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Currency	Value	% Change	Value on Increase	Value on Decrease
	£'s		£'s	£'s
Australian Dollar	1,244,824	8.87%	1,355,240	1,134,408
Brazilian Real	602,479	11.69%	672,909	532,049
Danish Krone	1,279,889	6.19%	1,359,114	1,200,664
Canadian Dollar	1,504,095	6.65%	1,604,117	1,404,073
EURO	9,467,145	6.15%	10,049,374	8,884,916
Hong Kong Dollar	4,154,939	7.74%	4,476,531	3,833,347
Japanese Yen	11,305,831	11.02%	12,551,734	10,059,928
Norwegian Krone	1,541,199	8.64%	1,674,359	1,408,039
South African Rand	5,197,101	10.72%	5,754,230	4,639,972
Swedish Krona	4,339,177	7.30%	4,655,937	4,022,417
Swiss Franc	5,001,253	9.34%	5,468,370	4,534,136
US Dollar	78,876,035	7.78%	85,012,591	72,739,479
Pooled Assets	3,029,704	6.09%	3,214,213	2,845,195
<b>Total</b>	<b>127,543,671</b>		<b>137,848,719</b>	<b>117,238,623</b>

#### 25.4 Credit risk

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

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

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its treasury management arrangements at 31 March 2015, including current account cash, was £82k. (31 March 2014: £693k). This was held with the following institutions:

	Rating (Fitch)	Balance 2014/15 £'000s
<b>Bank current accounts</b>		
Royal Bank of Scotland	A	82

## 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 2015, the Fund had no illiquid assets.

## 26. Funding and Valuation Note

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

The key elements of the funding policy are:

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

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

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

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

Owing to volatility in the financial markets in the year following the actuarial review, it was decided to hold the pooled contribution rate at its previous level of 21.4% for the 15/16 year with a reduction in the rate to 19.8% in 2016/17 and 19.2% in 2017/18.

In accordance with the Funding Strategy Statement the administering authority has adopted employer contributions from 2013/14 to 2015/16 of 21.4%. The valuation of the Fund has

been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service. The principal assumptions were:

### Financial Assumptions

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

\* GMP = guaranteed minimum pension

### Mortality assumptions

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

### 27. Additional Voluntary Contributions

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

During the year, member contributions amounted to £0.370m (2013/14: £0.322m).

Members contributions are invested in a "with profits" Fund or a "deposit" Fund. During the year the value of AVC investments increased by £0.111m to £2.230m as at 31 March 2015 (2014: £2.119m) excluding the final bonus.

# **Independent Auditor's Report**

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

I certify that I have audited the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2015 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the 2014/15 Code).

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

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

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

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

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

### **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2014/15 Code of the financial transactions of the fund during the year ended 31 March 2015, 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 2014/15 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

### **Opinion on other prescribed matter**

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

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

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

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

I have nothing to report in respect of these matters.



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18 September 2015

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

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

#### **Scheduled Bodies**

- Orkney Islands Council

#### **Admitted Bodies**

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

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

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

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

## **Annex 2 – Actuarial Statement for 2014/15**

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

This statement has been prepared in accordance with Regulation 34A (1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2014/15.

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

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

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

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

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

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

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

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

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

## Method

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

## Assumptions

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

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

Financial assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.1%	2.4%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	-

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

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

\*Future pensioners are assumed to be currently aged 45

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



### **Experience over the period since April 2014**

Experience has been worse than expected over the year to 31 March 2015 (excluding the effect of any membership movements). Real bonds yields have fallen dramatically and the effect of this has been only partially offset by the effect of strong asset returns, meaning that funding levels are likely to have worsened and the surplus is likely to have decreased over this period.

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

### **Barry McKay FFA**

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For and on behalf of Hymans Robertson LLP  
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15 May 2015

## **Annex 3 - Glossary of Terms**

### **Active Management**

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

### **Asset Allocation**

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

### **Balanced Management**

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

### **Growth Manager**

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

### **Mandate**

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

### **Passive Management**

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

### **Pooled Fund**

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

### **Return**

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

### **Risk**

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

**Segregated Fund**

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

**Specialist Management**

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

**Value Manager**

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

**Vested/Non Vested Obligations**

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

**Pension Fund Strain**

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

**Operating Surplus/Deficit**

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

## Additional Information

### Key Documents Online

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

- Annual Report and Accounts

### Fund Advisers

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

### Contact Details

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

Bryan Hay	Telephone 01856873535	Extension 2108
Pensions Manager	E-mail <a href="mailto:bryan.hay@orkney.gov.uk">bryan.hay@orkney.gov.uk</a>	

Scheme members should have a copy of the “Employees’ Guide to the Local Government Pension Scheme Administered by the Orkney Islands Council”, and can obtain their own copy of an Annual Report on request.

or visit Orkney Islands Council Pension Fund website at: [www.orkney.gov.uk](http://www.orkney.gov.uk).

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

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