

Item: 3

Pension Fund Sub-committee: 31 August 2023.

Pension Fund – Draft Financial Statements.

Report by Corporate Director for Enterprise and Sustainable Regeneration.

1. Purpose of Report

To present the draft Annual Report and Accounts of the Pension Fund for financial year 2022/23.

2. Recommendations

It is recommended:

2.1.

That the draft Annual Governance Statement, comprising pages 17 to 24 of the draft Annual Report and Accounts of the Orkney Islands Council Pension Fund for financial year 2022/23, attached as Appendix 1 to this report, be approved.

2.2.

That the draft Annual Report and Accounts of the Orkney Islands Council Pension Fund for financial year 2022/23, attached as Appendix 1 to this report, be approved.

3. Background

3.1.

A requirement exists for each Council, in its role as Administering Authority, to prepare an annual set of Pension Fund Accounts which are to be lodged with the Council's external auditors by 30 June each year. The accounts are then subject to an audit verification process which concludes with an independent opinion being expressed on the accuracy and/or quality of the financial statements themselves. The Pension Fund accounts, together with an appropriate audit certificate, should then be available for publication by 31 October each year.

3.2.

The purpose of the annual Pension Fund accounts is to demonstrate proper stewardship of the Pension Fund's financial affairs.

4. Annual Governance

4.1.

The Local Authority Accounts (Scotland) Regulations 2018 require an annual review of the effectiveness of the Fund's system of internal control. The findings of that review should be considered by the elected members, and following that review, members are requested to approve the annual governance statement.

4.2.

The Annual Governance Statement is contained within the draft Annual Report and Accounts for financial year 2022/23, at pages 17 to 24, attached as Appendix 1 to this report.

4.3.

A governance compliance statement is contained in the draft Annual Report at pages 25 to 28 and sets out the extent to which the Orkney Islands Council Pension Fund governance arrangements comply with best practice. Governance arrangements have been modified over recent years to bring the fund governance into line with best practice.

5. Pension Fund Financial Statements

5.1.

The Annual Accounts for Orkney Islands Council Pension Fund for the year ended 31 March 2023, attached as Appendix 1 to this report, have been prepared in accordance with proper accounting practice as required by section 12 of the Local Government in Scotland Act 2003. Proper accounting practice comprises:

- The Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code) and the Service Reporting Code of Practice, supported by International Financial Reporting Standards.
- Recommendations made by the Local Authority (Scotland) Accounts Advisory Committee.
- Practices set out in the Financial Report of Pension Schemes – A Statement of Recommended Practice (2015) (the Pensions Statements of Recommended Practice).
- The Chartered Institute of Public Finance and Accountancy's Accounting for Local Government Pension Scheme Management Expenses (2016).

5.2.

The management commentary provides an overview of the most significant matters reported in the Annual Accounts for the year ended 31 March 2023. These issues can be summarised as follows:

- Overall, the activities of the Fund returned a net loss of £28,664,000 for the year.

- The main source of this loss can be attributed to the following:
 - Loss on changes in market value of investments of £30,574,000.
 - Benefits payable to members of £10,276,000.
 - Payments to and on account of leavers of £3,212,000.
 - Management costs of £2,783,000.
- The main sources of the loss were offset by the following income:
 - Investment Income of £9,577,000.
 - Contributions and transfers into the fund of £13,002,000.
 - Loss on disposal of investments of £4,239,000.
- The main risk facing the Pension Fund remains, as in previous years, that the Fund's assets fail to grow in line with the cost of meeting its liabilities. This financial mismatch is managed by the Pension Fund Sub-committee in several ways, including, for example, implementing a diversified investment strategy.
- During the year to 31 March 2023, net assets of the Pension Fund decreased by £28,664,000 or 5.6%, from £508,531,000 to £479,867,000. Movements included the following:
 - A decrease in the value of investment assets and managed funds of £27,509,000 to £479,407,000.
 - A decrease in current assets of £915,000 to £1,143,000.
 - An increase in current liabilities of £240,000 to £683,000.
- The Pension Fund suffered a loss relative to withdrawals from dealing with members of £486,000. However, this figure includes a large bulk transfer out of the Pension Fund on 31 March 2023 relating to the Highlands and Islands Enterprise Company transferring their staff who were still part of the admitted body in the Orkney Islands Council Pension Fund, across to the Highland Council Pension Fund.
- Investment activities through the Pension Fund generated a loss of £25,395,000.
- Fund membership increased by 389 in the year to 31 March 2023, from 4,339 to 4,728.

5.3.

In financial terms, the accounts demonstrate that the Pension Fund remains in good health, despite its net worth decreasing by £28,664,000 to £479,867,000 for the year to 31 March 2023.

5.4.

The most recent funding update produced by the Pension Fund's actuaries as at 31 March 2023 indicated that the extent by which assets exceeded fund liabilities has decreased since the last full valuation, carried out in 2020. Year on year the funding level has increased by 22% at 31 March 2023, from 137% to 159%.

6. Corporate Governance

This report relates to the Council complying with its governance and financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

7. Financial Implications

Existing staff resources are deployed as part of the annual financial year end closedown process to prepare the annual accounts for the Council.

8. Legal Aspects

8.1.

Section 95 of the Local Government (Scotland) Act 1973 states that every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for the administration of those affairs.

8.2.

The requirement for a local authority to keep accounts is established in Section 96 of the 1973 Act.

8.3.

The Accounting Code constitutes proper accounting practices in terms of Section 12 of the Local Government in Scotland Act 2003, under the statutory framework provided by the Local Authority Accounts (Scotland) Regulations 2014.

9. Contact Officers

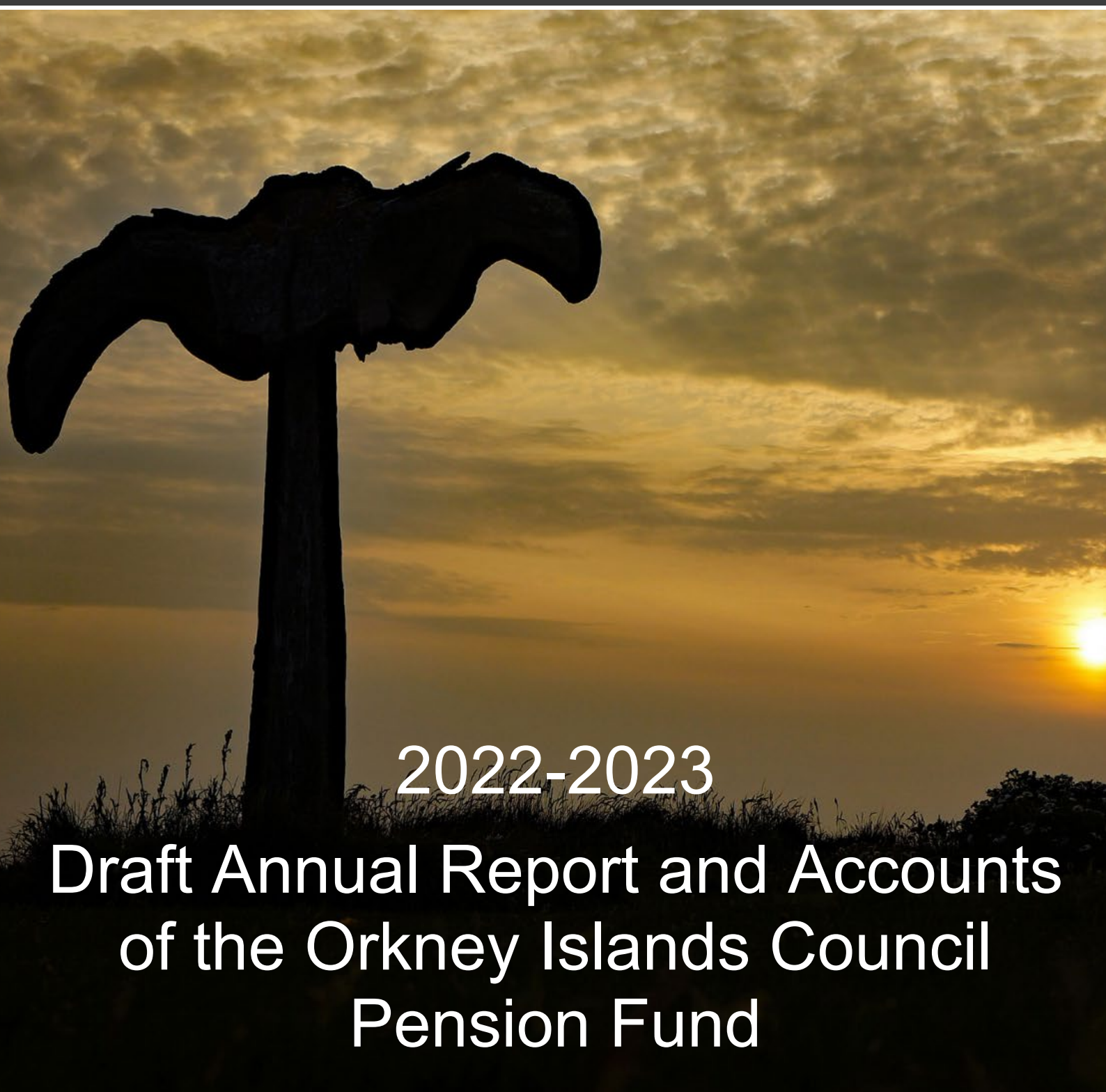
Gareth Waterson, Corporate Director for Enterprise and Sustainable Regeneration, extension 2103, Email gareth.waterson@orkney.gov.uk.

Erik Knight, Head of Finance, extension 2106, Email erik.knight@orkney.gov.uk.

Shonagh Merriman, Service Manager (Corporate Finance), extension 2105, Email shonagh.merriman@orkney.gov.uk.

10. Appendix

Appendix 1: Draft Annual Report and Accounts of the Orkney Islands Council Pension Fund 2022/23.



2022-2023

**Draft Annual Report and Accounts
of the Orkney Islands Council
Pension Fund**

Contents

Management Commentary	1
Statement of Responsibilities for the Annual Accounts	15
Remuneration Report	17
Annual Governance Statement.....	18
Governance Compliance Statement.....	26
Annual Accounts 2022-2023.....	30
Pension Fund Account.....	30
Net Assets Statement as at 31 March 2023	31
Notes to the Annual Accounts	32
Independent Auditor's Report	56
Annex 1 - Scheduled and Admitted Bodies	57
Annex 2 – Actuarial Statement for 2022-2023	58
Annex 3 - Glossary of Terms	60
Additional Information	62

Management Commentary

Introduction

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2023.

The Local Government Pension Scheme (Scotland) Regulations 2018 require the Council, as administering authority for the Fund, to produce a separate statement of accounts for the Pension Fund and incorporate it into an Annual Report.

This Annual Report has been produced to provide Elected Members, employers, scheme members and other interested parties with information concerning the administration and performance of the fund for financial year 2022-2023 and we hope you find its content useful.

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

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

Overview of Fund Business

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

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

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

Review of the Year

Key Facts and Figures:
Value of the Fund at 31 March 2023 was £479.9 million (£508.5m at 31 March 2022).
An Operational and Investment Income Loss of £28.7 million was incurred on the activities of the fund (compared to a loss of £12.3m for the year ended 31 March 2022).
The decrease in fund value over the year was largely the result of a decrease in the market value of investments of £34.8m. Outflows, including benefits payable (£10.3m) and management expenses (£2.8m) were offset by investment income of £9.6m and contributions receivable of £11.9m. A further significant outflow was incurred with a group transfer out of (£3.1m). Overall, this represents a year-on-year decrease of 5.6% in the value of the fund.
Performance of the Fund on a three-year rolling average basis has been 8.1% p.a., giving a relative return below benchmark of 1.0%.
Fund membership increased by 389 to 4,728.
Employers contributed £8.7 million to the Fund (£8.2m to 31 March 2022).
Employees contributed £3.2 million (£2.9m to 31 March 2022).
Pension and other benefits paid out were £10.3 million (£9.2m to 31 March 2022).
Transfer values paid into the Fund because staff changed employers was £1.1 million (£0.8m to 31 March 2022).
Transfer values out of the Fund because staff changed employers was £3.2 million (£0.7m to 31 March 2022), including a group transfer of £3.1 million (£0m to 31 March 2022).

Over the 2022/23 financial year, the Fund returned -5.6% as investment markets, as a whole, faced a challenging year.

The majority of mandates had negative returns this year on absolute terms except for the IFM Global Infrastructure fund. However, the overall performance over the longer term remains positive in absolute terms.

Within the Fund's growth assets, Baillie Gifford's Diversified Growth fund and Multi-asset fund (c. 19% of holdings), had the worst performance over the 12-month period, underperforming the benchmark by 15.5% and 13.6% (net of fees), respectively. Despite a sign of improvement in the first quarter of 2023, the 1-yr return remains negative in absolute terms for both mandates. Holdings in listed equities and property were the main detractor for both mandates during the year ended 31 March 2023.

In a similar fashion, the Baillie Gifford Global Alpha fund performed poorly over the year, returning -4.4%, in absolute terms, during the last 12 months. Overweight exposure to high-duration stocks and underweight exposure to defensive names contributed heavily to the relative performance during the year.

The Baillie Gifford UK equity fund held on better (in absolute terms) in comparison to other growth assets within the Fund over the 12-month period, albeit underperformed its benchmark by 5.6% (net of fees). Lack of exposure to energy stocks detracted dearly from the overall performance as oil companies were reporting a record profit. The energy sector outperformed the rest of the market significantly as high oil prices provided a tailwind for the sector.

The Fund's protection assets with LGIM, (fixed-interest and index-linked) also contributed negatively to the overall performance, returning -23.6% combined. Fixed income assets suffered throughout the year as high inflation and rising interest rate expectations resulted in the rise of yields and the fall in prices (bond prices fall as their yields rise). UK bonds in particular sold off following the aftermath of the "mini-budget" coupled with rapidly rising rates throughout the year as the Bank of England have been attempting to tame inflation. Both funds account for 7% of the pension Fund's AUM as of 31 March 2023.

In contrast to other mandates, IFM Infrastructure had a positive return over a 12-month period in absolute terms, returning 9.1%, albeit it's falling behind the benchmark by 0.8%. We note it is too early to meaningfully evaluate the manager's performance, given this is a relatively newly appointed manager.

The overall benchmark return of -1.9% generally reflects variable market conditions for investors over the 12 months to 31 March 2023.

The table shown within the Investment strategy section, page 6, details the allocation of the fund within asset class or pooled investment vehicle.

The value of the fund decreased by £28.7m or 5.6% in the financial year and totalled £479.9m at 31 March 2023.

The change in value of the fund over any given period is a combination of the net money flows into or out of the Fund and any gain or loss on the capital value of its investments. During the year, a loss on member contributions receivable and transfers in over pension payments and management expenses of £3.3m (2022: £0.7m loss) was offset by income from dividends and interest of £9.6m (2022: £8.0m). The fund was further reduced by a net capital loss of £34.8m (2022: £19.6m loss).

The Accounts are based on the market value of investments at 31 March 2023. This means that they include the profit or loss that has been made, due to the change in the value of investments, over the period from the date of their purchase to 31 March 2023 even though no actual sale has taken place. This notional value is defined as "unrealised" profit or loss. By contrast "realised" profits and losses are those that have arisen from actual sales throughout the year. Of the net capital loss of £34.8m in the year, £30.6m was an unrealised loss (2022: £53.4m loss) and £4.2m realised loss (2022: £33.9m realised profit).

After allowing for projected liabilities on the fund, the funding level has increased to 159% at 31 March 2023 from its value of 137% last financial year end, calculated on an ongoing funding basis. This improved investment outlook has been partially offset by an increase to future inflation expectations.

We are pleased to report that the Fund maintains a position above its 100% funding target, being in surplus by £178m at the financial year end (2021/2022: £137m) according to the actuary's most recent funding update.

Economic and Market Background

Global growth slowed over 2022 amid soaring interest rates and inflation but falling energy prices, strong labour markets, and firm consumption have led to an unexpected resilience in recent economic data. As a result, 2023 GDP forecasts for the major advanced economies have seen upwards revisions in recent months. However, the quarterly pace of global growth is expected to ease from here as the lagged impact of interest rate increases weighs on activity and the boost from China's re-opening fades.

Year-on-year headline CPI inflation peaked at 11.1%, 10.6% and 9.1% in the UK, eurozone and US, respectively in the second half of 2022. Despite an easing in inflation, largely owing to falling energy prices, headline CPI remains elevated in March 2023, at 10.1%, 6.9% and 5.0% in the UK, eurozone and US, respectively. Core inflation measures, which exclude volatile energy and food components, also remain well in excess of central bank targets: year-on-year core CPI in the UK, eurozone and US stood at 6.2%, 5.7%, and 5.6% in March 2023.

In response, the major central banks have embarked on one of the most aggressive rate hiking cycles on record amidst concerns that core inflation might become ingrained. Interest rates were raised from historically low levels; reaching 5.0% p.a., 4.25% p.a., and 3.0% p.a., in the US, UK and eurozone, respectively.

High inflation and interest rate rises saw yields and volatility rise sharply in government bond markets. In the wake of the UK's mini-budget in September, selling of gilts by leveraged investors threatened to get out of control, with yields only falling back from their September peak following intervention by the Bank of England. UK 10-year yields increased from 1.6% p.a. to 3.5% p.a. while equivalent US yields rose 1.2% p.a., to 3.5% p.a., and German yields increased 1.7% p.a., to 2.3% p.a. UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, fell 0.8% p.a. to 3.6% p.a.

Despite recent tightening, inflation and growth concerns weighed on credit markets over the past year, with global investment grade credit spreads widening 0.3% p.a. to 1.5% p.a. and speculative-grade credit spreads widening 0.9% p.a., to 5.1% p.a.

Despite rallying strongly since its low in October 2022, the FTSE All World Index Total Return Index fell 5.0% over the period. Energy was the best performing sector, boosted by surging oil and gas prices during the first half of the year. Consumer discretionary and technology were among the worst performing sectors over the year amidst cost-of-living pressures and rising rates, while recent banking stresses resulted in a significant hit to financial stocks.

The improvement in consumer and business sentiment in Europe, off the back of falling gas prices towards the end of the year, led European equities to outperform. UK equities also experiences an outperformance due to above average exposure to the energy sector and sterling weakness for the most part of 2022, particularly against the dollar, which flattered the large proportion of overseas earnings in the index.

The UK sterling and Japanese yen fell 2.7% and 4.2% respectively over the past 12 months in trade-weighted terms while equivalent dollar and euro measures rose 4.2% and 2.9%, respectively.

The MSCI UK Monthly Property Total Return Index declined 14.7% year-on-year primarily due to a 18.8% fall in capital values. Values fell across the three main commercial sectors and were most pronounced in the industrial sector.

Resilient economic data has raised global growth forecasts for 2023, but quarter-on-quarter GDP growth is expected to ease beyond the first quarter as the lagged effects of ongoing monetary-policy tightening by major central banks weigh on economic activity. Against a backdrop of high headline CPI inflation and stubborn core inflation pressures, further rate hikes by the major central banks are likely and hopes that rates may start to fall in 2023 look overdone.

A challenging outlook favours higher quality bond and credit assets. While interest rates may not fall as quickly as markets expect in the near-term, bond yields remain at attractive levels relative to long-term fair value. Expectations that growth will slow and inflation will fall sharply this year should led support to government bonds. However, upside inflation risks and a high degree of uncertainty around where inflation will settle increases the relative attraction of index-linked gilts. The extent of the relative attraction of index-linked over nominal gilts is not constant by term, with nominals preferred at longer-terms.

Property values may come under further pressure from tighter bank lending standards. Capital values continued to decline first quarter of 2023, but the rate of decline is starting to ease, and aggregate valuations saw their first monthly increase since June 2022 in March 2023, as retail and industrial values rose while office capital values continued to fall.

While nominal rental growth remains positive, high inflation means rental growth remains deeply negative in real terms. Furthermore, alongside an increase in inducements offered to tenants by proprietors and a decline in occupational demand, the latest UK Commercial Property Market Survey by the Royal Institute of Chartered Surveyors points to further declines in rent expectations.

Given the decline in capital values and rising rents, yields have risen sharply over the past 6 months. However, net initial yields remain unattractive versus longer-term history, and indeed relative to other income generating assets on a risk adjusted basis. Furthermore, the recent turmoil in the US banking sector, alongside existing affordability headwinds, may place further pressure on capital values as tighter bank lending standards deter leveraged buyers.

Investment Strategy

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

A revised investment strategy was approved in February 2019. The process of transitioning to the revised strategy started during 2019 with the selection, appointment, and onboarding of new fund managers. The process of diversification commenced in financial year 2019/20 but was delayed due to COVID-19 related volatility being experienced in the markets and was still ongoing during financial year 2022/23. Significant steps have been taken towards the Fund's interim-target allocation during the year. The revised asset allocation and range guidelines were applied with effect from December 2019, and further reviewed in February 2022. The agreed long term target allocations are shown in the Asset Allocation table below together with the actual asset allocation at 31 March 2023.

Asset Class	Asset Allocation at 31/03/2023	Range Guideline	Fund Specific Benchmark
	%	%	%
Growth			
UK Equities	9.6	41-61	7.0
Overseas Equities	50.0		36.0
Global Pooled - Diversified/Multi-Asset Growth	19.0	14-34	17.0
Income			
Infrastructure Credit	4.8	0-20	10.0
Private Debt	8.8		10.0
Protection			
UK Gilts	3.7	5-25	10.0
UK Index-Linked Gilts	3.3		10.0
Cash	0.8	0-10	0.0
Total	100.00		100.0

The Fund has acted to reduce its holdings in growth-seeking assets in favour of funding a new allocation to income generating assets as part of a strategy to further diversify the Fund's investments. Nevertheless, holdings in equities still account for 59.6%, with indirect holdings in Diversified Growth and Multi-Asset Growth pooled funds accounting for a further 19.0% of the Fund's portfolio as at 31 March 2023. The remaining 21.4% is held in Infrastructure Credit, Private Debt, Bonds and Cash at 4.8%, 8.8%, 7.0% and 0.8% respectively.

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

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

The top 10 direct equity holdings within the fund at 31 March 2023 were:

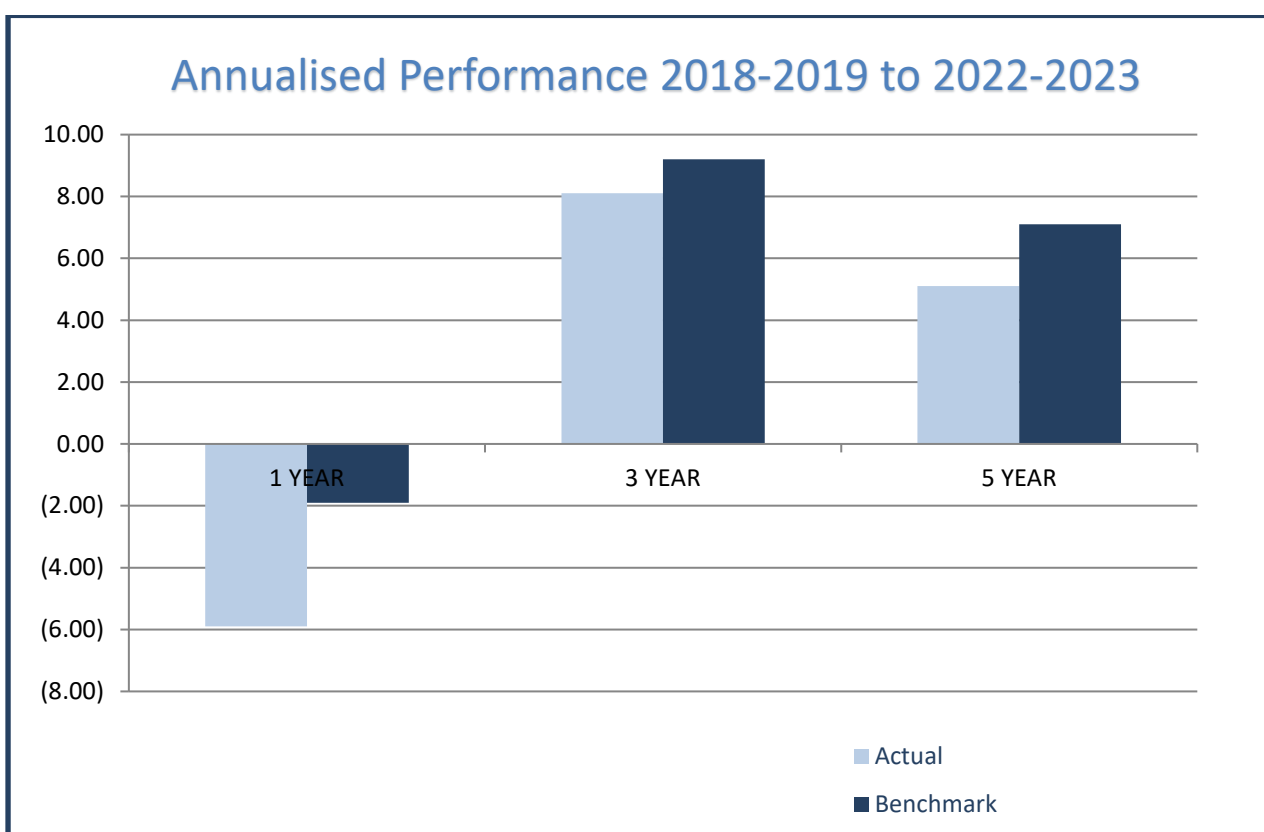
Company	Market Value of Holding £m
Baillie Gifford Diversified Growth Fund C Acc*	46.0
Baillie Gifford Multi Asset Growth Fund C Acc*	44.9
Prosus N.V.	8.6
Elevance Health Inc	8.5
Microsoft	7.9
Moody's	7.3
Martin Marietta Materials	7.0
Service Corp.Intl.	6.1
Rio Tinto	5.9
Reliance Inds. GDR	5.8

* Capital Accumulated.

Investment Performance

The performance of the Pension Fund managed investments has been measured against a bespoke or fund specific benchmark since the 1 April 2017, following the closure of the previous peer group benchmark, and reflects the weighting or concentration of individual asset classes within the approved investment strategy. The benchmark is maintained by Hymans Robertson. A revised investment strategy was approved in February 2019 and included principally new allocations to infrastructure equity and private debt, funded by a further reduction in the Fund's exposure to equities. The weightings of the fund specific benchmark were subsequently amended in December 2019 to reflect the revised investment strategy and signalled the start of the process to transition the Fund's investments to the new strategy. The Fund's performance target for this accounting period is to outperform the fund specific benchmark measured over a rolling 5-year period. The average performance over the last 5 years of 5.1% is behind the benchmark of 7.1%.

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



Structure of Administration

Staffing

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

The Pensions team within the Payroll and Pensions section has 3.7 full time equivalents, consisting of a Service Manager, one full time Senior Assistant, two part time Senior

Assistants and an Administrative Assistant. In addition to maintaining scheme members' records using data supplied by all Fund employers, the Pensions team also provides frontline services to scheme members. As well as answering telephone calls and responding to electronic and written correspondence, meetings are provided where requested.

The staff resources detailed above are supplemented by shared staff resources within the Enterprise & Sustainable Regeneration Service, providing additional governance, payments, investment, and accounting expertise. In addition, the Human Resources and Organisational Development section, within Orkney Islands Council's Strategy, Performance & Business Solutions Service also supports the work of the Pension section by arranging pre-retirement workshops for scheme members who are within two years of retirement.

Systems

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

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

Administration Performance

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

Administration performance figures are monitored by the Pension Fund for financial year 2022-2023, against the key service standards set by the Pension Fund Sub-committee, as follows:

Category	Performance Standard – No of Working Days	Number of records processed within standard	Number of records processed Outwith standard	Percentage of records processed within standard	Prior Year Performance
New Entrant Information	10	286	0	100.0%	100.0%
Leaver Information	10	161	1	99.4%	100.0%
Deferred Benefit Information	1 Month	109	0	100.0%	100.0%
Pension Estimates	10	128	6	95.5%	96.8%
Retirements	5	112	0	100.0%	100.0%
Transfers In	10	47	3	94.0%	94.4%
Transfers Out	10	6	0	100.0%	100.0%
Refunds	5	33	0	100.0%	84.6%

Fund Update

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

Membership	2021-2022	2022-2023
Contributing members	2,126	2,167
Pensioners	1,161	1,392
Deferred members	1,052	1,169
Total	4,339	4,728

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

Employer Bodies

The Fund invested and administered pensions on behalf of 5 current and former employers during financial year 2022-2023. 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 27 of the Annual Report and Accounts for the Fund.

Pension Increases

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

Actuarial Valuation

Annex 2 contains the formal Actuarial Statement for financial year 2022-2023 which is prepared in line with International Accounting Standard (IAS) 26 and supports the preparation of the Financial Statements for the Pension Fund.

The last triennial valuation, as at the 31 March 2020, calculated that the Fund's assets were valued at £377m, and were sufficient to meet 118.0% of the liabilities (i.e., the present value of promised retirement benefits) accrued up to that date. This compared with 113% at the previous March 2017 valuation. The resulting surplus at the 2020 valuation was £58m.

For the purpose of reporting a funding level and an associated surplus/deficit for the 2020 valuation a prudent future investment return of 2.9% p.a with a 75% likelihood of success has been used, this compared to 3.1% p.a for the 2017 valuation.

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

Since the previous valuation, various events have taken place which affect the value placed on the liabilities, including:

- Increase due to interest applied to the previous valuation liability value – the benefits that have been accrued to the valuation date are three years closer to payment at 31 March 2020 than they were at 31 March 2017, meaning there is less opportunity for future investment returns to help meet this cost.
- Decrease due to changes to the longevity assumptions used for the valuation resulting in a modest reduction in life expectancies.
- Decrease due to a reduction in the assumed rate of future CPI inflation, from 2.4% p.a at 31 March 2017 to 1.7% at 31 March 2020.
- Increase due to a reduction in the assumed rate of future investment returns, from 3.1% at March 2017 to 2.9% at March 2020.

This overall increase in liabilities has been offset by an increase in the Fund's assets resulting from a positive investment return and a net cash inflow over the period since the last full valuation at 31 March 2020.

As recommended by the Fund's actuary (Hymans Robertson) the employers contribution rate has been maintained at 17.0% for the period 01 April 2021 to 31 March 2024 with reference to the future costs and also taking account of the current funding position, which is based on past service benefits

The LGPS regulations state that a Primary Contribution Rate should also be set, which is the cost of active members accruing benefits in the scheme. There is currently an upward pressure on the Primary Rate due to a reduction in the future yields on investments, resulting from rising inflation forecasts. This means that the current Primary Rate of 24% is now less likely to meet future service costs.

The most recent funding update produced at 31 March 2023 indicates that the funding surplus has increased from 137% to 159% since 31 March 2022. The improvement has been driven by strong invested performance since 31 March 2020 and the changes to the economic outlook. A summary of these results is shown below:

	31 March 2022	31 March 2023
Assumed Future Investment Return (Based on a 75% Likelihood of Success)	3.6% p.a.	5.2% p.a.
Salary Increase Assumption	3.3% p.a.	3.0% p.a.
Pension Increase Assumption	2.8% p.a.	2.5% p.a.
Assets	£507m	£479m
Past Service Liabilities	£370m	£301m
Surplus/ (Deficit)	£137m	£178m
Funding Level	137%	159%
Future Investment Return Required to be 100% Funded	2.0% p.a.	2.6% p.a.
Likelihood of Achieving This Return	90%	95%

The assessed Primary contribution rate for 1 April 2020 – 31 March 2024 at March 2020 was 24.0%. On applying a Secondary contribution rate of -7.0% to give a required minimum contribution, against the background of increased uncertainty over the future impacting on actuarial assumptions the employer contribution rate will be maintained at 17.0% for the three-year period 2021 to 2024.

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 29 risks faced by the fund and can be viewed at the related downloads section [here](#). The risk register is reviewed annually by the Pension Fund Sub-committee and Pension Board.

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

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

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

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

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

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

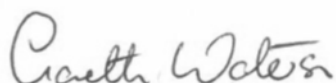
Pension Fund Sub-Committee and Pensions Board

In line with Scheme regulations, and the respective terms of reference for the Pension Fund Sub-committee and Pensions Board, the group met concurrently on four occasions during 2022-2023.

Training activity for the members of the Pension Fund Sub-committee and Pension Board was undertaken during the financial year 2022-2023, in accordance with the agreed training plan, to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively. In recognition of the complex and ever-changing environment of Local Government Pension Scheme finance, and specifically to address the governance requirements, the Chartered Institute of Public Finance and Accountancy Code of Practice on Public Sector Pensions Finance Knowledge and Skills has been adopted.

Acknowledgement

We would like to take this opportunity to thank our colleagues in the Enterprise & Sustainable Regeneration Service and the members of the Pension Fund Sub-committee and the Pensions Board for their help and co-operation in managing the financial affairs of the Pension Fund.



Gareth Waterson, BAcc, CA
Section 95 Officer

30 June 2023

Councillor James Stockan
Leader

30 June 2023

Oliver D Reid
Chief Executive

30 June 2023

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 Corporate Director of Enterprise & Sustainable Regeneration.
- 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 the Local Authority (Capital Finance and Accounting) (Scotland) (Coronavirus) Amendment Regulations 2021, and so far, as is compatible with that legislation, in accordance with proper accounting practices (Section 12 of the Local Government in Scotland Act 2003).
- Approve the Annual Accounts for signature.

Signed on behalf of Orkney Islands Council

Councillor James Stockan
Leader

30 June 2023

The Corporate Director of Enterprise & Sustainable Regeneration Service responsibilities

The Corporate Director of Enterprise & Sustainable Regeneration 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).

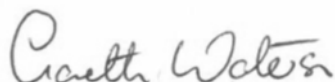
In preparing these Annual Accounts, the Corporate Director of Enterprise & Sustainable Regeneration has:

- 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 Corporate Director of Enterprise & Sustainable Regeneration Service 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 2023, and of its transactions for the year ended 31 March 2023.



Gareth Waterson, BAcc, CA
Section 95 Officer

30 June 2023

Remuneration Report

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

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

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

Details of Councillor and Senior Employee remuneration can be found in the accounts of Orkney Islands Council on the Council's website:

https://www.orkney.gov.uk/Council/Statement_of_Accounts/Statement-of-Accounts.htm.

Annual Governance Statement

Scope of Responsibility

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

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

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the Chartered Institute of Public Finance & Accountancy (CIPFA)/Society of Local Authority Chief Executives and Senior Managers (SOLACE) framework 'Delivering Good Governance in Local Government'. The Code is available on the Council's website. The authority's financial and management arrangements conform to the governance requirements of the CIPFA Statement on the role of the Chief Financial Officer in local government.

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

Purpose of the Governance Framework

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

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

The governance framework has been in place for the year ended 31 March 2023 and up to the date of approval of the Annual Accounts.

Governance Framework

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

6. Managing risks and performance through robust internal control and strong public financial management.

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

Review of Effectiveness

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

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

Administering Authority

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

The Council has delegated the management of the investments of the Pension Fund to the Pension Fund Sub-committee and has established a Pension Board which is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations, and the requirements of the Pension Regulator.

Regulatory Framework

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

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

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

The Pension Fund Sub-committee is a formal sub-committee of Orkney Islands Council's Policy and Resources Committee. The Scheme of Administration for the Council refers the responsibility to discharge all functions and responsibilities relating to the Council's role as administering authority for the Orkney Islands Council Pension Fund in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.

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

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

Pension Fund Sub-Committee and Pension Board

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

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

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

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

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

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

The Pension Fund Sub-committee meets at least quarterly. Additional meetings are called as appropriate and papers and minutes are publicly available on the Council's website, unless they have been considered as private business in terms of Schedule 7A to the Local Government (Scotland) Act 1973. Minutes of the Pension Fund Sub-committee are also presented to the Policy and Resources Committee of the Council.

Membership of the Pensions Board consists of equal numbers made up of 4 trade union representatives and employer representatives, drawn from Orkney Islands Council and scheduled or admitted bodies who are members of the Pension Fund. Pension Board representatives may not participate in or act as members of the Pension Fund Sub-committee or the Monitoring and Audit Committee. Local Authority employer representatives will normally be Elected Members of the Council.

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

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

During the year 2022/23 there was no disagreement however, if the Pension Fund Sub-committee and Pension Board cannot reach joint agreement on any matter the process for resolving any differences between the two bodies is as follows:

- In the first instance, if at least half of the members of the Pension Board agree, then the Pension Board can defer a decision of the Pension Fund Sub-committee for further

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

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

Administration and Financial Management of the Fund

The Council's Corporate Director of Enterprise & Sustainable Regeneration is the Officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.

The Corporate Director of Enterprise & Sustainable Regeneration is responsible for:

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

The day-to-day management of the investment activities of the Fund is administered by the Corporate Finance Team within the Enterprise & Sustainable Regeneration Service.

The pension benefits policy oversight and day-to-day administration for the Fund is administered by the Pensions Team within the Enterprise & Sustainable Regeneration Service.

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

Professional Advisers and External Service Providers

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

The implementation of the revised investment strategy approved in February 2019 involved Fund Manager appointments to new Infrastructure Equity, Private Debt and Bonds mandates. The Bonds mandate was fully funded in May 2020, while the Infrastructure Equity was fully drawn down in December 2021. The drawdowns to the Private Debt funds continued throughout 2022/2023 financial year.

In February 2022, when considering a review of the investment strategy, the Pension Fund Sub-committee agreed to allocated up to 4% to a new renewable focussed infrastructure mandate, to be managed by a renewable focussed manager. Following Interviews in September 2022 fund managers were successfully appointed for the new renewable focussed infrastructure mandate. The onboarding process was completed in March 2023, there has been no drawdown of funds to the new mandate as yet.

The Fund's appointed investment managers have responsibility for the selection, retention, and disposal of individual investments. Where appropriate, they also implement the Pension Fund Sub-committee's policy in relation to socially responsible investment and corporate governance. All fund managers are required to be signatories of the United Nations' Principles for Responsible Investment.

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

Internal and External Control and Review

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

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

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

The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and the Orkney Islands Council's independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

The Pensions team within the Payroll and Pension section consists of 3.7 full time equivalents.

The Corporate Director of Enterprise & Sustainable Regeneration (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 made available to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.

The Chief Internal Auditor (CIA) reports to the Monitoring and Audit Committee and functionally to the Head of Legal and Governance who is also the Council's Monitoring Officer. He is in regular contact with the Head of Finance and Monitoring Officer. The CIA provides an independent and objective internal audit annual report and assurance statement on the effectiveness of internal control, risk management and governance based on the delivery of an approved plan of systematic and continuous internal audit review of the Council's arrangements.

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

Counter Fraud and Anti-Corruption

Effective counter fraud and anti-corruption arrangements are developed and maintained in accordance with the Code of Practice on Managing the Risk of Fraud and Corruption. This includes, but is not limited to, ensuring established systems of internal controls and security are in place, segregation of duties and supervisory checking of all calculations, and internal audit and monitoring arrangements.

The increased risk of fraud and scams is also being managed on an ongoing basis, focusing on staff support, communication of potential scams and close monitoring of checks prior to any transfers out being completed. These steps are further enhanced by the development of a new on-line training course which is mandatory for all Finance staff.

Risk Management

The Fund's Risk Register was last reviewed and updated at the concurrent meetings of the Pension Fund Sub-committee together with the Pensions Board on 15 February 2023. The risk register incorporates a risk matrix to clearly demonstrate the Pension Funds current threats relative to the individual risks anticipated, and a summary and prioritisation of risks to indicate the descriptive risks ranking.

Risk awareness is embedded into the investment performance management process.

The main changes identified in the last review of the risk register were as follows:

- The risk added in 2021 regarding working from home whenever possible in accordance with Government COVID-19 mitigation measures has been removed following the removal of Government guidance to work from home and the return to the workplace.
- The likelihood of the risk regarding short-term and long-term impacts on the investment returns due to the COVID-19 pandemic has been lowered to 4 due to the reducing impact of the pandemic while it remains a risk due to the continuing uncertainty on the long-term impact on the investment returns of the Fund.
- The likelihood of the risk regarding Committee and Board members having inadequate knowledge and understanding has been increased to 4 to reflect the fact that four members of the Pension Fund Sub-Committee and two members of the Pension Board were only nominated in 2022 and have had limited time to build up their knowledge and understanding of the Pension Fund. This risk should reduce over the term of the Council and as the members attend more training events.
- The impact of the risk regarding Brexit risks potentially impacting the Fund's assets and liabilities has been reduced to 1 which reflects the fact that the initial impact of leaving the European Union on 31 January 2020 has now passed. However, it has been left on the Risk Register to recognise the fact that a custom deal and the Northern Ireland Protocol still has to be agreed.
- A risk has been added regarding significant disruption of global stock markets. This risk has been given a rating of 8 as the Fund has already experienced large market fluctuations in the value of the investments but should be protected by a robust investment strategy.

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

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

Significant Governance Issues

The system of governance aims to provide reasonable, but not absolute, assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or detected within a timely period and significant risks impacting on the achievement of our objectives have been mitigated to an acceptable level. A review of effectiveness of the governance framework has not identified any significant governance issues or control weaknesses in the Pension Fund's governance arrangements.

The following issues were highlighted in the Audit Report for financial year 2021-2022:

- The financial statements were not advertised in accordance with the Local Authority Accounts (Scotland) Regulations 2014.

Agreed action - The accounts closure timetable has been updated to include this date and ensure it is met going forward.

- Details of the internal control reports received on our investment managers and custodian are not currently provided to members of the pension fund sub-committee.

Agreed action – Details of investment manager internal control reports will be provided to members of the pension fund sub-committee along with any observations raised by management going forward.

- The custodian covers investments held by only one of the four fund managers. The custodian holds the Fund's securities for safekeeping in order to minimise the risk of their misappropriation, misuse, theft and loss.

Agreed action – A review of existing operations will include expanding the role of custodian.

Access to Information

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

Opinion

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

- The work of Internal Audit and the professional pensions and accountancy staff within the Council.
- The External Auditor's reports.
- The Corporate Director of Enterprise & Sustainable Regeneration (Section 95 Officer), whose duties include putting in place the arrangements for the proper administration of financial affairs of the Pension Fund.

The internal financial control environment was enhanced through the adoption in 2015 of a Risk Register, Procedural Standing Orders, and the establishment of a scheme of delegation for the Pension Fund Sub-committee and supported by the Pension Board.

It is our opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal financial control systems during the year ended 31 March 2023.

Councillor James Stockan
Leader

30 June 2023

Oliver D Reid
Chief Executive

30 June 2023

Governance Compliance Statement

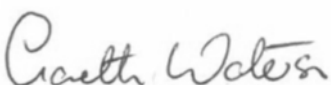
The Regulations that govern the management of LGPS funds in Scotland require that a Governance Compliance Statement is published. The following compliance statement sets out the extent to which the Orkney Islands Council Pension Fund governance arrangements comply with best practice.

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

d) 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.	The PSC and PB sit at the same place and time to assist with the formation of a consensus. The aim is to engender a positive and proactive partnership culture where in practice the two bodies act as one.
2. Representation	
a) That all key stakeholders are afforded the opportunity to be represented within the Pensions Board. These include: <ul style="list-style-type: none"> • Employing authorities including non-scheme employers, e.g., admitted bodies. • Scheme members including deferred and pensioner scheme members <ul style="list-style-type: none"> • Where appropriate, independent professional observers, and • Expert advisors (on an ad-hoc basis). 	<p>Compliance in Full: Yes</p> <p>In accordance with the terms of reference for the operation of the PB, membership comprises 8 members: four trade union representatives and four employer representatives.</p> <p>Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters.</p>
b) That where lay members sit on a main or secondary committee, they are treated the same as elected Members in terms of access to papers, meetings and training, and are given full opportunity to contribute to the decision-making process, with or without voting rights.	<p>Compliance in Full: Yes</p> <p>In accordance with the terms of reference, all members of the PB and PSC are treated equally. The two bodies sit at the same time to facilitate equal opportunity.</p>
3. Selection and Role of Lay Members	
a) That committee or panel members are made fully aware of the status, role, and function that they are required to perform on either a main or secondary committee.	<p>Compliance in Full: Yes</p> <p>At the inaugural meeting of the Pension Fund Sub committee and Pensions Board, held concurrently on 24 April 2015, respective Terms of Reference were duly approved for each body. In addition, an induction programme has been provided to members. Induction training was provided in June 2022 to new members following the local elections in May 2022.</p> <p>During 2021, members participated in 2 training seminars provided by the Scottish LGPS.</p>
b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	<p>Compliance in Full: Yes</p> <p>The declaration of Member's interests is a standard item on the agenda of the PSC and PB.</p>

4. Voting	
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.	Compliance in Full: Yes
	Full voting rights are given to all members of the PSC.
5. Training/ Facility Time/ Expenses	
a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Compliance in Full: Yes
	The CIPFA Code of Practice for Public Sector Pensions Finance Knowledge and Skills, together with a Knowledge and Skills Framework to support the Code has been adopted as the basis for training and development of members and officers involved in Pension Fund financial matters. CIPFA Framework Members' training is funded from the Council's Pension Fund. The training policy was approved in 2015/16 and is aligned to CIPFA's Knowledge and Skills Framework.
b) That where such a policy exists it applies equally to all members of committees, sub-committees, advisory panels, or any other form of secondary forum.	Compliance in Full: Yes
	All elected and lay members are treated equally under the training policy.
c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Compliance in Full: Yes
	The Administering Authority of the Pension Fund Sub-committee and Pension Board has to date considered the training requirements of committee members collectively and provided training on that basis. A log has been established of all training provided to members and this is monitored and reported as appropriate. The annual training plan for 2022-23 was approved by the PSC at its meeting of 23 February 2022.
6. Meeting Frequency	
a) That an administering authority's main committee or committees meet at least quarterly	Compliance in Full: Yes
	The PSC and PB are scheduled to meet at least four times a year.

b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Compliance in Full: Yes
	The PSC and PB are scheduled to meet at least four times a year.
c) That an administering authority that does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Compliance in Full: Yes
	On 17 February 2015, the PSC agreed to establish a Pensions Board (PB), with representatives from Trade Unions and admitted bodies.
7. Access	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Compliance in Full: Yes
	All members are treated equally.
8. Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliance in Full: Yes.
	The PSC deal with all matters relating to both the administration and investment of the Pension Fund. The PSC is formed from members of the Policy and Resources Committee of the Council.
9. Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders, can express an interest in wanting to be part of those arrangements.	Compliance in Full: Yes.
	The Orkney Islands Council Pension Fund governance documents are available on the Council website using the following link: Pension Board Terms of Reference (orkney.gov.uk) The Council as administering authority communicates regularly with employers and scheme members.



Gareth Waterson, BAcc, CA
Section 95 Officer

30 June 2023

Councillor James Stockan
Leader

30 June 2023

Oliver D Reid
Chief Executive

30 June 2023

Annual Accounts 2022-2023

Pension Fund Account

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

2021-2022 £'000		2022-2023 £'000	Notes
	Dealings with members, employers and others directly involved in the scheme		
11,103	Contributions Receivable	11,857	5
833	Transfers In	1,145	7
11,936		13,002	
(9,171)	Benefits Payable	(10,276)	6
(738)	Payments to and on account of leavers	(3,212)	8
(9,909)		(13,488)	
2,027	Net additions from dealings with members	(486)	
(2,678)	Management Costs	(2,783)	19
(651)	Net additions including management expenses	(3,269)	
	Return on Investments		
8,005	Investment Income	9,577	9
(19,596)	Profits/(losses) on disposal of investments and changes in the market value of investments	(34,813)	10
(74)	Taxes on Income	(159)	
(11,665)	Net Return/(Loss) on Investments	(25,395)	
(12,316)	Net increase/(decrease) in the net assets available for benefits during the year	(28,664)	
520,848	Opening Net Assets of the Scheme	508,531	
508,531	Closing Net Assets of the Scheme	479,867	13

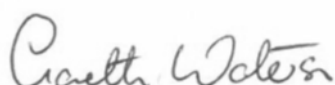
Net Assets Statement as at 31 March 2023

The Net Assets Statement sets out the value, as at the statement date, of all assets and current liabilities of the Fund. The net assets of the Fund (assets less current liabilities) represent the funds available to provide for pension benefits as at 31 March 2023.

31 March 2022 £'000		31 March 2023 £'000	Notes
	Managed Funds		
298,603	Equities	284,853	
205,061	Pooled Investment Vehicles	190,653	
3,252	Cash Equivalents	3,901	
506,916		479,407	11
	Current Assets		
6	Cash Balances	6	
99	Contributions due	98	
1,953	Current Debtors	1,039	
2,058		1,143	17
	Current Liabilities		
(443)	Current Creditors	(683)	18
1,615	Net Current Assets/(Liabilities)	460	
	Net Assets of the Scheme available to fund benefits at the year end	479,867	
508,531		479,867	

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 30 June 2023.



Gareth Waterson, BAcc, CA
Section 95 Officer

30 June 2023

Notes to the Annual Accounts

1. The Local Government Pension Scheme

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

2. Basis of Preparation of the Financial Statements

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

The accounts for the Fund have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2022-2023 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

3. Statement of Accounting Policies

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

3.1. Basis of Preparation

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

3.2. Transfers to and from other schemes

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

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

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

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

3.3. Financial Instruments

Investments

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

The values of investments as shown in the net assets statement have been determined at a fair value in accordance with the requirements of the Code and IFRS 13 (see note 14). For the purposes of disclosing levels of fair value hierarchy, the fund has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures. Market values, which are assessed as follows:

- 3.3.1. Market quoted securities are valued at bid market prices on the final day of the accounting period.
- 3.3.2. Fixed interest securities are valued at a market value based on current yields at 31 March 2023.
- 3.3.3. Pooled investments, which comprise the fund manager's unit trusts and open-ended investment companies, are valued at closing bid prices where bid and offer prices are published or closing single price where single price is published.
- 3.3.4. Unquoted equity/debt and infrastructure asset valuations are provided by fund administrators following independent validation.

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

3.4. Recognition of Income and Expenditure

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

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

3.5. Cash and Cash Equivalents

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

3.6. Administrative Overheads

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

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

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

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

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

3.8. Investment Income

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

3.9. Contributions Income

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

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

Augmentation contributions are contributions paid to the Fund by an employer where that employer awards compensatory added years to a scheme member at retirement. Strain costs are contributions paid to the Fund by an employer where a scheme member, aged 55 or over, chooses to retire prior to normal pension age and the employer elects to waive any reductions normally applied to the member's pension benefits. Strain costs are also paid to the Fund by an employer where a scheme member, aged 55 or over, retires prior to normal pension age and the grounds for retirement are redundancy or efficiency.

3.10. Foreign Currency

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

3.11. Management Expenses

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

3.12. Acquisition Cost

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

3.13. Critical Judgements in Applying Accounting Policies Pension Fund Liability

The Pension Fund liability is calculated every three years by the appointed actuary. The methodology used is in line with accepted guidelines and in accordance with International Accounting Standard IAS 26. The judgements which have the greatest impact on pension fund liabilities are those around the discount rate, the inflation rate, and the life expectancy of members.

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

The Statement of Accounts contains estimated figures that are based on assumptions made by the Pension Fund about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends, and other relevant factors. However, because such factors cannot be determined with certainty, actual results could be materially different from the assumptions and estimate. The items in the financial statements at 31 March 2023 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.
Unquoted Private Debt	Unquoted private debt investments are valued by the administrators of the specialist pooled Fund using various valuations techniques that require significant judgement in determining appropriate assumptions. In recognition that these investments are relatively illiquid and to ensure objectivity in the valuation process the results are then validated by independent administrators. Nevertheless, as these investments are not publicly listed there is a greater degree of subjectivity and estimation involved in the valuation process. Pooled Investment - Private Debt £42,076m - there is a risk that this investment may be under or overstated in the accounts.
Unlisted Infrastructure	For infrastructure preferred equity or infrastructure debt investments held within an Infrastructure equity fund, the method of valuation of assets is market value provided by an approved data provider, unless there is no market, or it does not represent fair value in which case another method will be determined. As these investments are also not publicly listed there is a greater degree of subjectivity and estimation involved in the valuation process. Pooled Investment – Infrastructure Equity £22.992m – there is a risk that this investment may be under or overstated in the accounts.

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

Change in assumptions at year ended 31 March 2023	Approximate % increase to Employer Liability	Approximate monetary amount £'000
0.1% decrease in Real Discount Rate	2%	6,053
1 year increase in member life expectancy	4%	12,456
0.1% increase in the Salary Increase Rate	0%	585
0.1% increase in the Pension Increase Rate	2%	5,558

3.15. Accounting Standards that were issued but not yet adopted

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

- IAS 8 Amendments – Definition of Accounting Estimates.
- IAS 1 Amendments – Disclosure of Accounting Policies.
- IAS 12 Amendments – Deferred Tax relating to Assets and Liabilities arising from a Single Transaction.

These amendments help give clarification or are generally minor in nature, and as such are not expected to have a significant impact on the Pension Fund.

3.16. Events after the Balance Sheet

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

- 3.16.1. 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.
- 3.16.2. those that are indicative of conditions that arose after the reporting period – the Statement of Accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

The draft annual accounts were signed by the Corporate Director of Enterprise & Sustainable Regeneration on 30 June 2023. Events taking place after the date of authorisation for issue have not been reflected in the financial statements. Material events between the balance sheet date and the date of signing have been considered and where necessary reflected in the financial statements.

4. Actuarial Present Value of Promised Retirement Benefits

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

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

The actuarial present value of promised retirement benefits at 31 March 2023 was £324m (2022: £485m).

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

Financial Assumptions

Year Ended	31 March 2022	31 March 2023
	% p.a.	% p.a.
Inflation/Pensions Increase Rate	3.20%	2.95%
Salary Increase Rate	3.70%	3.45%
Discount Rate	2.70%	4.75%

Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 29.

Longevity Assumptions

	31 March 2022		31 March 2023	
	Males	Females	Males	Females
Current Pensioners	21.3 years	23.7 years	20.9 years	23.4 years
Future Pensioners*	22.9 years	25.9 years	22.5 years	25.6 years

*Future pensioners are assumed to be aged 45 as at the last formal valuation.

Commutation assumption

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

5. Analysis of Contributions Receivable

	2021-2022			2022-2023		
	Orkney Islands Council £000	Admitted Bodies £000	Total	Orkney Islands Council £000	Admitted Bodies £000	Total
Employee Contributions	2,592	329	2,921	2,794	345	3,139
Employer Contributions	7,222	849	8,071	7,813	905	8,718
Strain Costs	111	0	111	0	0	0
Total	9,925	1,178	11,103	10,607	1,250	11,857

6. Analysis of Benefits Payable

	2021-2022			2022-2023		
	Orkney Islands Council £000	Admitted Bodies £000	Total	Orkney Islands Council £000	Admitted Bodies £000	Total
Pensions Paid	6,449	266	6,715	7,028	284	7,312
Dependants Pensions	475	21	496	506	25	531
Lump Sums Paid	1,688	43	1,731	1,831	66	1,897
Death Grants Paid	135	94	229	536	0	536
Total	8,747	424	9,171	9,901	375	10,276

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

7. Transfers In

Transfers into the scheme during 2022-2023 were £1.1m (2021-2022: £0.8m). This represents the total of transfer values in respect of individual members joining the scheme.

8. Payments to and on Account of Leavers

2021-2022		2022-2023
£'000		£'000
(13)	Contributions Returned	(22)
(725)	Individual Transfers to other Schemes	(117)
(0)	Group Transfers *	(3074)
(738)		(3,213)

*Highlands and Islands Enterprise Orkney transferred out during 2022/2023

9. Investment income

	2021-2022 £'000	2022-2023 £'000
Equities		
Equities UK	2,266	1,466
Equities Global	2,056	2,560
Total Equities	4,322	4,026
Pooled Investment Vehicle - Multi-Asset Growth	1,330	1,009
Pooled Investment Vehicle - Diversified Growth	1,107	1,086
Pooled Investment Vehicle - Private Debt	1,103	2,889
Pooled Investment Vehicle – Infrastructure	142	521
Interest on Cash and Deposits	1	46
Totals	8,005	9,577

10. Change in the Market Value of Investments

	2021-2022 £'000	2022-2023 £'000
Realised	33,853	(4,239)
Unrealised	(53,449)	(30,574)
Total	(19,596)	(34,813)

11. Analysis of Investments

As at 31 March 2023 the market value of the assets under management is as follows:

	31 March 2022 £'000	31 March 2023 £'000
Equities		
UK		
Quoted	46,885	46,078
Overseas		
Quoted	253,269	239,980
Total Equities	300,153	286,058
Pooled Fund - Multi-Asset Growth	62,575	44,908
Pooled Fund - Diversified Growth	50,165	46,000
Pooled Fund – Infrastructure	21,125	22,992
Pooled Fund - Private Debt	25,857	42,076
Pooled Fund - Fixed Income	43,789	33,472
Total Pooled Fund	203,511	189,448
Cash and Deposits	3,252	3,901
Totals	506,916	479,407

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

	31 March 2022 £'000	%	31 March 2023 £'000	%
Baillie Gifford	416,145	82.1	380,867	79.4
Barings	25,857	5.1	42,076	8.8
IFM	21,125	4.2	22,992	4.8
LGIM	43,789	8.6	33,472	7.0
Totals	506,916	100.0	479,407	100.0

12. Reconciliation of Movements in Investments

Investments decreased in value to £479.4m as at 31 March 2023 (2022: £506.9m) a movement of £27.5m.

During 2022-2023, sales of investments totalled £40.6m and purchases totalled £51.1m, including £14.8m and £15.2m respectively relating to the transitioning to the revised investment strategy. Transaction costs are included in the cost of purchases and sales proceeds.

The following individual investments exceed 5% of the total value of the net assets of the Pension Fund at 31 March 2023.

	31 March 2022 £'000	31 March 2023 £'000
Baillie Gifford & Company - (Multi Asset Growth)	62,575	44,908
Baillie Gifford & Company - (Diversified Growth)	50,165	46,000

13. Investment Transactions

2022-2023	Opening Market Value £'000	Purchases £'000	Sales £'000	Change in Market Value £'000	Closing Market Value £'000
Investment Assets – Managed Funds					
Equities	298,603	28,949	(28,278)	(14,421)	284,853
UK Bonds	0	0	0	0	0
Index Linked Bonds	0	0	0	0	0
Pooled Investment – British Small Companies	1,551	31	0	(377)	1,205
Pooled Investment - Private Equity	25,856	16,091	0	129	42,076
Pooled Investment – Infrastructure	21,125	68	0	1,799	22,992
Pooled Investment – Fixed Income	43,789	0	0	(10,317)	33,472
Pooled Investment – Multi-Asset Growth	62,575	1,008	(12,300)	(6,375)	44,908
Pooled Investment – Diversified Growth	50,165	1,086	0	(5,251)	46,000
Total Transactions	503,664	47,233	(40,578)	(34,813)	475,506
Cash Deposits	3,252	0	0	649	3,901
	506,916				479,407
Internal Net Current Assets / (Liabilities)	1,614				460
Total	508,530				479,867

2021-2022	Opening Market Value £'000	Purchases £'000	Sales £'000	Change in Market Value £'000	Closing Market Value £'000
Investment Assets – Managed Fund					
Equities	344,032	58,202	(82,297)	(21,334)	298,603
UK Bonds	0	0	0	0	0
Index Linked Bonds	0	0	0	0	0
Pooled Investment – British Small Companies	1,910	14	(17)	(356)	1,551
Pooled Investment - Private Equity	15,366	10,359	0	131	25,856
Pooled Investment - Infrastructure	0	19,981	0	1,144	21,125
Pooled Investment – Fixed Income	43,891	(2)	0	(100)	43,789
Pooled Investment – Multi-Asset Growth	61,641	934	0	0	62,575
Pooled Investment – Diversified Growth	48,139	1,107	0	919	50,165
Total Transactions	514,979	90,595	(82,314)	(19,596)	503,664
Cash Deposits	5,321	0	0	(2,069)	3,252
	520,300				506,916
Internal Net Current Assets / (Liabilities)	548				1,614
Total	520,848				508,530

14. Fair Value Hierarchy

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

Level 1

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

Level 2

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

Level 3

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

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

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

Valuations on infrastructure assets are carried out by independent valuers with extensive experience, resources, and reputation. Independent valuers are rotated every 3 years by tender process. The valuation methodology is determined by the independent valuer subject to meeting appropriate accounting standards.

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

Fair Value Through Fund Account	31 March 2022 £'000	31 March 2023 £'000
Level 1: Quoted Market Price	301,855	288,753
Level 2: Using Observable Inputs	158,080	125,585
Level 3: With Significant Unobservable Inputs	46,981	65,068
Net Investment Assets	506,916	479,407

Transfers Between Levels 1 and 2

There have been no transfers between Levels 1 and 2 during 2022/2023.

Reconciliation of Fair Value Measurements Within Level 3

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

	Market Value 31 March 2022 £'000	Transfers Into Level 3 £'000	Transfers Out Of Level 3 £'000	Purchases During the Year £'000	Sales During the Year £'000	Unrealised Gains/ (Losses) £'000	Realised Gains/ (Losses) £'000	Market Value 31 March 2023 £'000
Private Debt	25,857	0	0	16,331	0	(112)	0	42,076
Infrastructure Equity	21,125	0	0	3,667	0	(1,800)	0	22,992

Basis of Valuation

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

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

Sensitivity of Assets Valued at Level 3

Having analysed historical data, current market trends and consulted with independent advisors, the Fund has determined that the valuation methods described above are likely to be accurate to within the following ranges and has set out the consequent potential impact on the closing value of investments held at 31 March 2023.

Asset Type	Assessed Valuation Range (+/-)	Value at 31 March 2023	Value on Increase	Value on Decrease
		£'000	£'000	£'000
Private Debt	9.0%	42,076	45,863	38,289
Infrastructure Equity	16.0%	22,992	26,349	19,635

The underlying assets in private debt are a series of privately originated loans. The underlying assets in the infrastructure fund are high quality, essential and long-duration infrastructure. As such the valuations of these loans could move due to changes in a number of factors and assumptions including short term interest rates, inflation, the outlook for the profitability of the component companies and the likelihood of these companies to repay the loans. The potential movement of +/- 9.0% reflects the extent to which this value could vary based on each of these factors and assumptions.

15. Financial Instruments

Categories of Financial Instruments.

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

Financial Instruments Balances	31 March 2022	31 March 2023
	£'000	£'000
Investments		
Financial Assets at fair value through profit/loss	503,664	475,506
Cash and cash equivalents	3,252	3,901
Total Investments	506,916	479,407
Current Assets and Liabilities		
Debtors	2,058	1,143
Financial liabilities at amortised cost	(443)	(683)
Total Current Assets and Liabilities	1,615	460

Income, Expenses, Gains and Losses

Financial Instruments Gains/Losses	31 March 2022	31 March 2023
	Financial Assets	Financial Assets
	£'000	£'000
Net gains/(losses) on financial assets at fair value through profit and loss	(19,596)	(34,813)
Investment Income	8,005	9,577
Investment management expenses including taxation	(2,753)	(2,942)
Total Investment Gains and Losses	(14,344)	(28,178)

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 on a Fair Value Hierarchy detailed at Note 14.

16. Risk and Risk Management

The Fund's primary long-term risk is that the Fund's assets fall short of its liabilities (i.e., promised benefits payable to members). Therefore, the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the

opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. Responsibility for managing the Fund's risk rests with the Pension Fund Sub-committee, who approved the revised investment strategy in February 2019.

16.1 Market risk

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

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

Sensitivity analysis

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

Asset Type	Potential Market Movement +/- (%p.a.)
UK Equities	18.2
Global Equities	19.0
UK Index-Linked Gilts (long term)	8.9
UK Fixed Interest Gilts (medium term)	6.0
Diversified Growth	13.3
Private Debt	9.6
Infrastructure Equity	16.0
Cash	0.3
Total Fund Volatility	15.0

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

			Potential change in year in the net assets available to pay benefits	
Asset Type	Value	Change	Favourable Market Movement	Unfavourable Market Movement
	£'000	%	£'000	£'000
UK Equities	46,078	18.2	54,465	37,692
Global Equities	239,980	19.0	285,575	194,383
UK Index-Linked Gilts (long term)	15,663	8.9	17,057	14,269
UK Fixed Interest Gilts (medium term)	17,809	6.0	18,878	16,741
Diversified Growth and Multi Asset Growth	90,908	13.3	102,999	78,818
Private Debt	42,076	9.6	46,115	38,037
Infrastructure Equity	22,992	16.0	26,671	19,313
Cash	3,901	0.3	3,913	3,889
Total Fund Volatility	479,407	15.0	551,319	407,496

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

6.2 Interest Rate Risk

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

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

The Fund's direct exposure to interest rate movements as at 31 March 2023 and 31 March 2022 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

	31 March 2022 £'000	31 March 2023 £'000
Cash and cash equivalents	3,252	3,901

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 2023 £'000	Potential change in year in the net assets available to pay benefits	
		1% Interest Movement £'000	-1% Interest Movement £'000
Cash and Cash Equivalents	3,901	39.0	(39.0)
Total Change in Assets Available	3,901	39.0	(39.0)

16.3 Currency Exposure Risk

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

The following table summarises the Fund's currency exposure at 31 March 2023:

Currency exposure - asset type	Asset value 31 March 2022 £'000	Asset value 31 March 2023 £'000
Overseas Quoted Equities	248,785	228,253
Pooled Funds - Global Basket	30,341	53,802
Total	279,126	282,055

Sensitivity analysis

Following analysis of historical data in consultation with Hymans Robertson, the council considers the likely volatility associated with foreign exchange movements to be 9.9%.

A 9.9% fluctuation is considered reasonable based on Hyman's analysis of long-term historical movements. This analysis assumes that all other variables, in particular interest rates, remain constant.

A 9.9% strengthening/weakening of the pound against the various currencies in which the fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Assets exposed to currency risk	Asset Value as at 31 March 2023 £'000	Potential Movement %	Value on Increase £'000	Value on Decrease £'000
Overseas Quoted Equities	228,253	9.9%	250,850	205,656
Total Change in Assets Available to Pay Benefits	228,253	9.9%	250,850	205,656

16.4 Credit Risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's

financial assets and liabilities. The selection of high-quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

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

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its treasury management arrangements at 31 March 2023, including current account cash, was £0.006m. (31 March 2022: £0.006m). The Fund also held cash under its investment management arrangement. This was held with the following institutions:

	Rating (Fitch)	Balance 31 March 2023 £'000
Bank current accounts		
Royal Bank of Scotland	A+	6
Cash held in Portfolio		
Bank of New York Mellon (BNY)	AA	1,984

6.5 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 2023, the Fund had illiquid assets of £65.068m (2021-2022: £46.981m).

17. Current Assets

	31 March 2022 £'000	31 March 2023 £'000
Income Due	793	597
Recoverable Tax	231	312
Cash Balances	6	6
Transfer Values Receivable	140	75
Contributions Due - Employers	71	71
Contributions Due - Employees	28	27
Orkney Islands Council	788	0
Sundry Debtors	1	55
Total Current Assets	2,058	1,143

18. Current Liabilities

	31 March 2022 £'000	31 March 2023 £'000
Orkney Islands Council	0	138
Sundry Creditors	401	396
Benefits Payable	41	149
Provision For Liabilities	1	0
Total Current Liabilities	443	683

19. Management Expenses

	2021-2022 £'000	2022-2023 £'000
Investment Management Expenses		
Investment managers fees	1,941	1,836
Custodian fees	27	66
Other Investment management expenses	186	183
Stamp Duty	7	0
Other Transaction Taxes and Levies	32	24
Broker Commission	38	22
Total Investment Management Expenses	2,231	2,131
Administration Costs		
Staff time and Support allocations	314	542
Total Administration Costs	314	542
Governance		
Audit costs	22	23
Professional fees	111	87
Total Governance Costs	133	110
Total	2,678	2,783

20. Code of Transparency

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

Total transaction costs for each asset class are detailed below:

2022-2023	Transaction Taxes £	Broker Commission £	Implicit Costs £	Indirect Transaction Costs £	Total Transaction Costs £
Equities	23,744	22,028	(52,707)	0	(6,935)
Bonds	0	0	0	0	0
Pooled Funds	0	0	28,077	623,968	652,045
Foreign Exchange	0	0	6,150	0	6,150
Cash Instruments	0	0	0	0	0
Total	23,744	22,028	(18,480)	623,968	651,260

2021-2022	Transaction Taxes £	Broker Commission £	Implicit Costs £	Indirect Transaction Costs £	Total Transaction Costs £
Equities	38,797	38,117	(80,864)	0	(3,950)
Bonds	0	0	0	0	0
Pooled Funds	0	0	93	447,553	447,646
Foreign Exchange	0	0	1,312	0	1,312
Cash Instruments	0	0	0	0	0
Total	38,797	38,117	(79,459)	447,553	445,008

The nature of the transaction costs groups are as follows:

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

In addition to the transaction costs, the portfolio has incurred indirect fees of £210,705 (2021-2022: £281,014) paid from the Net Asset Value of the pooled funds.

21. Audit Fees

In 2022-2023 the agreed audit fee for the year was £24,860 (2021-2022: £22,090).

22. Agency Arrangements

The Orkney Islands Council Pension Fund pays discretionary pensions to former employees of Orkney Islands Council who were awarded compensatory added years in accordance with the Orkney Islands Council's Early Retirement and Severance Scheme, but subject to limitations set out in the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulation 1998. The amounts paid are not included within the Fund Account but are provided as a service and fully reclaimed from the Council. The total amount of these payments was £225k in 2022-2023 (2021-2022: £245k).

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

23. Statement of Investment Principles and Funding Strategy Statement

The Council as Administering Authority approved its current Statement of Investment Principles in February 2020. The Statement defines the Fund's operational framework insofar as investments are concerned. It is reviewed periodically to ensure that it continues to reflect the needs of the Fund and the views of its stakeholders.

The Funding Strategy Statement defines how the Fund intends to meet its financial obligations and was effective from 10 May 2018.

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

24. Investment Management Arrangements

The Orkney Islands Council Pension Fund investments are managed on an active basis by external fund managers, with the exception of the Bonds which are allocated to a specialist passive manager.

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

25. Stock Lending

In accordance with the Statement of Investment Principles 2020, stock lending is not permitted within any of its segregated investment mandates. As at 31 March 2023 no stock had been released to a third party under a stock lending arrangement.

26. Related Party Transactions

Orkney Islands Council Pension Fund is administered by Orkney Islands Council. The Council incurred costs of £0.542m (2021-2022: £0.314m) 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 £7.81m to the fund in 2022-2023 (2021-2022: £7.33m). With the exception of the year end creditor balance shown at Note 18 all monies owing to and from the Fund were paid in the year.

The Fund had a balance due to Orkney Islands Council of £0.14m as at 31 March 2023 (£0.79m due from Orkney Islands Council as at 31 March 2022).

All the members of the Pensions Sub-committee and the members of the Pensions Board are active members of the pension scheme. Each Councillor is required to declare any financial or pecuniary interest related to specific matters on the agenda at each meeting.

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

	Accrued pension benefits 2021-2022		Accrued pension benefits 2022-2023	
	Pension £	Lump Sum £	Pension £	Lump Sum £
Corporate Director of Enterprise & Sustainable Regeneration / (Section 95 Officer)	43,148	56,035	43,920	58,167
Interim Head of Finance (to 12/09/2022) *	43,442	78,399	45,714	80,961
Head of Finance (from 15/08/2022) *	-	-	1,510	0

* Interim Head of Finance retired on 12/09/2022. New Head of Finance took up post on 15/08/2022.

27. Membership Details

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

Eligibility to join the scheme

Orkney Islands Council employees with a contract for 3 months duration or more are automatically entered into the LGPS. Employees with a contract of less than 3 months duration will be automatically enrolled into the LGPS if they satisfy the automatic enrolment criteria, however they can opt in if they do not meet the automatic enrolment criteria.

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

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

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

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

Membership Details at 31/03/2023	Active	Deferred	Pensioner	Dependant	Total
Orkney Islands Council	2,002	1,077	1,164	174	4,417
Orkney Islands Property Development	3	3	5	0	11
Pickaquoy Centre Trust	51	44	10	0	105
HIE Orkney	0	0	0	0	0
Orkney Ferries Limited	111	45	33	6	195
Summary of Members					
OIC	2,002	1,077	1,164	174	4,417
Admitted Bodies	165	92	48	6	311
Totals	2,167	1,169	1,212	180	4,728

28. Scheme Arrangements

Career Average Revalued Earnings Scheme (CARE) – LGPS 2015

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

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

The main changes of this scheme were:

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

29. Funding and Valuation Note

In line with the Local Government Pension Scheme (Scotland) Regulations 2018, 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 2020. The next valuation will take place as at 31 March 2023.

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 taxpayer 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 2020 actuarial valuation, the Fund was assessed as 118.0% funded (112.7% at the March 2017 valuation). This corresponded to a surplus of £58m (2017 valuation: surplus of £38m) at that time.

The assessed Primary contribution rate for 1 April 2021 – 31 March 2024 at March 2020 was 24.0%. On applying a Secondary contribution rate of -7.0% to give a required minimum contribution, against the background of increased uncertainty over the future impacting on actuarial assumptions the employer contribution rate will be maintained at 17.0% for the three-year period 2021 to 2024.

In accordance with the Funding Strategy Statement the administering authority has adopted employer contributions of 17.0% for 2022-2023. The valuation of the Fund has been

undertaken using a 'risk based' approach which considers how each employer's assets and liabilities may evolve over the future. The principal assumptions were:

	31 March 2017	31 March 2020
Financial Assumptions:		
<i>Salary and Benefit Increases & Investment Return</i>		
Benefit Increases & CARE Revaluation (CPI)	2.40%	1.70%
Salary Increases	2.80%	2.20%
Investment Return ('Discount Rate')	3.10%	2.90%
Demographic Assumptions:		
<i>Longevity</i>		
Baseline Longevity	Club Vita	Club Vita
Future Improvements	CMI 2016, Peaked, 1.25% p.a. long term	CMI 2019, Smoothed, 1.5% p.a. long term

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 2020.

30. Additional Voluntary Contributions

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

During the year 2021-2022 member contributions amounted to £0.517m. This information is not yet available from Prudential for the year to March 2023.

Member's contributions are invested in a "with profits" Fund or a "deposit" Fund. The value of AVC investments decreased by £1.642m to £1.173m as at 31 March 2022 excluding the final bonus. This information is not yet available from Prudential for the year to March 2023.

31. Contingent Liabilities and Contractual Commitments

In recognition of legal judgements, the funding valuation position included an allowance for full Guaranteed Minimum Pension equalisation (indexation) treatment since 31 March 2020. A further ruling on Guaranteed Minimum Pension historical transfers is unlikely to be significant in terms of impact on the pension obligations. An allowance for the estimated impact of the McCloud judgement is also included within the funding valuation position noted above. Whilst there is still uncertainty surrounding the potential remedy to the Goodwin judgement the approximate impact is likely to be minimal, therefore there has been no adjustment applied to the valuation.

The results of the 2017 cost cap were finalised in 2021/22 and suggest no changes to employer contribution rates recently certified and put in place by the LGPS administering authority from 1 April 2021.

As at the 31 March 2023, as part of the transitioning arrangements to the revised investment strategy, the Fund had contractual commitments to invest up to £2.6m and £32.0m across two new mandates to Private Debt. The drawdowns of these commitments are expected to continue over the next year and will be funded from within the Fund's portfolio of investments. A further contractual commitment to invest up to £20.0m was made during the year to a new renewable focussed infrastructure mandate. The onboarding process was complete by 31 March 2023 however, there have been no drawdowns to this new mandate to date.

Independent Auditor's Report

Annex 1 - Scheduled and Admitted Bodies

Orkney Islands Council Pension Fund

Scheduled Bodies

- Orkney Islands Council

Admitted Bodies - Active

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

Annex 2 – Actuarial Statement for 2022-2023

Orkney Islands Council Pension Fund (“the Fund”) Actuarial Statement for 2022/23

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2018. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The funding policy is set out in the Administering Authority’s Funding Strategy (FSS), dated March 2021. 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 Taxpayers).
- 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. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised to have a sufficiently high likelihood of achieving the funding target over 20 years. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 70% chance that the Fund will return to full funding over 20 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018 was as at 31 March 2020. This valuation revealed that the Fund’s assets, which at 31 March 2020 were valued at £377 million, were sufficient to meet 118% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2020 valuation was £58 million. Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers’ contributions for the period 1 April 2021 to 31 March 2024 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 2020 valuation report.

Method

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

Assumptions

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

Financial assumptions	31-Mar-20
Discount rate	2.9%
Pay increases	2.2%
Price inflation/Pension increases	1.7%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2019 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.5% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.5 years	23.9 years
Future Pensioners*	23.2 years	26.1 years

*Currently aged 45

Copies of the 2020 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

Experience over the period since 31 March 2020

Markets were severely disrupted by COVID-19 at the 31 March 2020 funding valuation date, resulting in depressed asset values but recovered very strongly in 2020 and 2021. Markets have continued to be disrupted by the ongoing war in Ukraine and inflationary pressures, impacting on investment returns achieved by the Fund's assets. High levels of inflation in the UK (compared to recent experience), have resulted in a higher than expected LGPS benefit increase of 10.1% in April 2023. Despite this, the funding level of the Fund is likely to be higher than reported at the 31 March 2020 funding valuation due to the significant rise in interest rates which reduces the value placed on the Fund's liabilities.

The next actuarial valuation will be carried out as at 31 March 2023. The Funding Strategy Statement will also be reviewed at that time.

Tom Hoare FFA
For and on behalf of Hymans Robertson LLP
6 June 2023

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:

[Pension Fund Annual Reports \(orkney.gov.uk\)](https://www.orkney.gov.uk), Including the following documents:

- Annual Report and Accounts

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

Contact Details

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

Robert Adamson Telephone: 01856 873535. Extension: 2108.
Pensions Manager Email: robert.adamson@orkney.gov.uk

Scheme members should have a copy of the “Employees’ Guide to the Local Government Pension Scheme Administered by the Orkney Islands Council” and can obtain their own copy of an Annual Report on request or visit Orkney Islands Council Pension Fund website at: <https://www.orkney.gov.uk/>.

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

Gareth Waterson Telephone: 01856 873535. Extension: 2521.
Corporate Director of Enterprise & Sustainable Regeneration Email: gareth.waterson@orkney.gov.uk

Erik Knight Telephone: 01856 873535. Extension: 2127.
Head of Finance Email: erik.knight@orkney.gov.uk