ORKNEY ISLANDS COUNCIL

ANNUAL REPORT AND ACCOUNTS OF THE PENSION FUND 2010/2011

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FOREWORD BY DIRECTOR OF FINANCE AND HOUSING

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year to 31st March 2011.

Despite nervousness among investors over the strength of the global recovery, the impact of a devastating earthquake and tsunami in Japan, and ongoing unrest in North Africa and the Middle East, there was also much encouraging economic news over the period, and stock markets around the world delivered positive returns over the year. Many of the perceived economic threats failed to materialise. China avoided the hard landing predicted by many observers, while, neither the UK nor the US was hit by the feared double-dip recession although inflationary pressures continued to grow. Eurozone countries had mixed fortunes, with the economic woes of Greece, Ireland, Spain and Portugal in sharp contrast to the strength of Germany which, during the final three months of 2010, recorded its best quarterly economic performance since reunification two decades earlier.

Against this background, the Pension Fund has performed very well over the last year and returned a gain on investments of 12.4% out performing the benchmark of 8.2% by 4.2%.

The Funds belonging to the Pension Fund are entirely managed by external investment managers Baillie Gifford & Co, and are held separately from any of the employing bodies which participate in the Pension Fund.

Our appointed external investment manager remains focused on the bottom-up analysis of companies to ensure as far as possible that the businesses in which we invest have good prospects for earnings growth over the longer term. They have been successful in identifying attractive investment opportunities in emerging markets, and in particular several companies which they believe have an excellent long-term outlook and are now, on a relative basis, looking attractive. The fund manager continues to favour corporate bonds over government bonds in the fixed interest markets.

During the final quarter of the year the Investment Guidelines were amended to introduce an exposure to diversified growth as a mechanism for managing the risk profile of the Fund more effectively in the future. These changes were approved after taking appropriate advice from the funds investment advisors.

As an administering authority, the Council has delegated the management of the Pension Fund administration and investments to an Investment Sub-Committee comprising of 5 elected members. The committee meets 3 times a year, with summary investment monitoring reports being issued directly to all members on a quarterly basis,

In respect of Pension Fund Administration, the number of contributing members reduced from 1,604 employees at 31 March 2010 to 1,588 employees at 31 March 2011 and the number of pension payments increased from 531 at 31 March 2010 to 569 at 31 March 2011.

I would like to take this opportunity to thank my colleagues in the Finance Department and the members of the Investment Sub-Committee for their help and co-operation in managing the financial affairs of the Pension Fund.

Gareth Waterson

Gareth Waterson, BAcc, CA
Director of Finance & Housing
Orkney Islands Council
30 September 2011

STATEMENT OF RESPONSIBILITIES FOR THE ANNUAL ACCOUNTS

The Administering Authority's Responsibilities

The Authority is required to:

- Make arrangements for the proper administration of the financial affairs of the Pension Fund in its charge and to secure that one of its officers has the responsibility for the administration of those affairs. In this Authority, that officer is the Director of Finance and Housing

- Manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets

The Director of Finance and Housing's Responsibilities

The Director of Finance and Housing is responsible for the preparation of the Pension Funds' statement of accounts which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom ('the Code of Practice'), is required to present a true and fair view of the financial position of the Pension Fund at the accounting date and the income and expenditure for the year (ended 31 March 2011).

In preparing the statement of accounts, the Director of Finance and Housing has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice, except where stated in the Statement of Accounting Policies and Notes to the Accounts

The Director of Finance and Housing has also:

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

Statement of Accounts

The Statement of Accounts presents a true and fair view of the financial position of the Pension Fund as at 31 March 2011, and of its income and expenditure for the year ended 31 March 2011.

Gareth Waterson

Gareth Waterson, BAcc, CA
Director of Finance & Housing
Orkney Islands Council
30 September 2011

INTRODUCTION

The Orkney Islands Council Pension Fund is constituted under the various Local Government Pension Fund Acts and related regulations and provides pension benefits to all local government employees, excluding principally teachers, of Orkney Islands Council, together with 13 other organisations of a statutory and voluntary nature which have been accepted into the fund as admitted bodies.

The Fund is built up from contributions from both employees and employing bodies, together with interest and dividends from investments, out of which pensions and other benefits are paid.

After meeting the cost of current benefits, all surplus cash income is invested and the increasing value of investment is then available to meet future liabilities to employees within the Fund. In addition to a contingent liability to meet future pension benefits payable to existing employees, the funds must also provide for the future payment of deferred pension benefits which have been preserved by former employees prior to their leaving.

Employees' contributions are fixed by statute, with employers' contributions being assessed every three years by an independent Actuary to determine the level of contribution necessary by employing bodies to ensure that the fund is able to meet all future benefits. The standard employee contributions range from 5.5% to 12.0%. Following completion of the 2008 Actuarial valuation, the employers' rate saw the implementation of a stepped increase from 17.4% in 2008 to 18.4% in 2009, rising to 20.4% in 2010 and 21.4% in 2011.

The funds have been invested in accordance with the investment controls laid down in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998 as amended and quoted investments of the fund have been revalued to market value at 31 March 2011.

MEMBERS AND ADVISORS

Investment Sub-Committee
The Orkney Islands Council carries out its administration functions through its Investment Sub-Committee, the remit for which is outlined in Appendix C. This responsibility is delegated through the Council's Policy and Resources Committee to the Investment Sub-Committee. The committee meets 3 times a year, with quarterly investment monitoring reports being issued directly to the sub-committee members throughout the year. Membership of the sub-committee as at 31 March 2011 is as noted below:

Councillors:
Convener S Hagan (Chair)
Vice Convener J Stockan
Councillor I Johnstone
Councillor M Drever
Councillor A Gordon

Fund Manager
Baillie Gifford & Co

Investment Advisors
Hymans Robertson

Actuaries
Hymans Robertson

Custodian
Bank of New York Mellon

Auditors
Scott-Moncrieff

Corporate Governance Advisors
Hymans Robertson

Performance Measurement
WM Company

FUND ADMINISTRATION

Membership
The Local Government Pension Scheme is voluntary and is open to all employees of the Scheduled and Admitted Bodies (see Appendix D).

Membership of the Orkney Islands Council Fund was:

	2010/11	**2009/10**
Contributing Members	1,588	1,604
Pensioners	569	531
Deferred Pensioners	694	602
	2,851	**2,737**

Membership Funding
The Fund is financed by the contributions made by members and their employers as well as income earned from the investment of the Fund's monies.

The contribution rates for 2010/2011 were as follows:

	% of Pensionable Pay	
	Employees	**Employers**
All Employees	5.5% - 12.0%	20.4%

The employees' contribution levels are now tiered based on a percentage of pensionable pay, whereas the employers' contribution levels are reviewed every three years by the Fund actuaries as part of their actuarial valuation of the Fund. If the actuaries believe that a surplus is likely to materialise they will recommend a reduction in the employers' contribution rate and if they believe a deficit is likely to materialise they will recommend an increase in the employers' contribution rate.

Hymans Robertson carried out an actuarial valuation as at March 2008. The result of the valuation for the Fund was as follows:

Actuarial Value of Assets	£110,542,000
Actuarial Value as a percentage of Accrued Liabilities	86%

Financial Year	Employers Contribution Rates
2010/2011	20.4%
2011/2012	21.4%

Membership Funding (cont.)
The common rate of contribution is the rate, which, in addition to the accumulated assets and contributions paid by members is sufficient to meet 100% of the liabilities of the Fund. This rate takes into account the deficit at 31 March 2011. The deficit is spread over the average remaining working lifetime of the existing members (approximately 20 years).

The Fund contribution rates following the 31 March 2008 valuation were calculated using the projected unit actuarial method.

The main actuarial assumptions were as follows:

Annual rate of price inflation	3.6%
Annual rate of pension increases:	
- on pension in excess of GMPs	3.6%
- on pension accrued after April 1997	3.6%
- on post-88 GMPs in payment	2.8%
- on pre-88 GMPs in payment	0.0%
Annual rate of increase of deferred pensions	3.6%
Annual rate of general pay increase	5.1%
Discount rate	6.1%
Expenses	0.6%

Market Value of Funds
The market value of investments can go down, as well as up. The total market value of the investments that are under external management was £159,702,882 as at 31 March 2011.

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 AVCs and are treated separately from the scheme's assets under arrangement with Prudential Assurance Company Limited.

During the year, member contributions amounted to £323K.

Members contributions are invested in “with profits” fund or a “deposit” fund. During the year, the value of AVC investments increased by £206K from £1,381K to £1,587K as at 31 March 2011.

Pension Increases
Pension and deferred pensions are increased every year under the Pension (Increase) Act 1971 in line with movements in the Retail Prices Index (Consumer Price Index with effect from 12 April 2011), which reflects general inflation. Recent increases under this provision are:

2006	2.7% (RPI)
2007	3.6% (RPI)
2008	3.9% (RPI)
2009	5.0% (RPI)
2010	0.0% (RPI)
2011	3.1% (CPI)

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 what governance arrangements comply with best practice.

Principle		Full Compliance	Comments
Structure	The management of the Administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council.	Yes	The Orkney Islands Council as administering authority has delegated all pension scheme matters to the Policy and Resources Committee and the Investment Sub Committee (ISC) which comprises of 5 elected members.
	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	No	The existing membership of the ISC includes both active and pensioner members of the Orkney Island Council Pension Fund. There are currently no admitted bodies or deferred members represented on the ISC or Policy and Resources Committee.
	That where a secondary committee of panel has been established, the structure ensures effective communication across both levels.	N/A	
	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.	N/A	
Representation	a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: • Employing authorities (including non-scheme employers, e.g. admitted bodies; • Scheme members (including deferred and pensioner scheme members • Where appropriate, independent professional observers, and • Expert advisors (on an ad-hoc basis).	No	Members of the Policy and Resources Committee and ISC are selected from the membership of the Council. Committee structure and responsibility for Pension Fund matters is currently under review. Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters

Principle		Full Compliance	Comments
	b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights	N/A	
Selection and Role of Lay Members	a) That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	The current arrangements whereby training is provided to members of the ISC on an ad-hoc basis, or where a specific needs has been identified, is under review. The CIPFA framework will be used to identify gaps in knowledge. Training for ISC members includes presentations from investment managers, actuary and investment advisors. Attendance at meetings and training is monitored and reported as appropriate.
	b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of Member's interests is a standard item on the agenda of the Investment Sub-Committee.
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.	Yes	Full voting rights are given to all members of the Policy and Resources Committee.
Training/ Facility Time/ Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	Members' training is funded from the Council's Pension Fund
	b) That where such a policy exists it applies equally to all members of committees,	Yes	All members are treated equally under the training policy

Principle		Full Compliance	Comments
	sub-committees, advisory panels or any other form of secondary forum.		
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	No	Annual training plans will be developed in the future. Members currently receive training each year and this is monitored and reported as appropriate.
Meeting Frequency	a) That an administering authority's main committee or committees meet at least quarterly	Yes	The Policy and Resources Committee and ISC are scheduled to meet at 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.	N/A	
	c) That an administering authority who 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.	No	These arrangements are currently under review.
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	All members are treated equally.
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Policy and Resources Committee and ISC deal with all matters relating to both the administration and investment of the Pension Fund.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	The Orkney Islands Council Pension Fund governance documents are available upon request. The Council as administering authority communicates regularly with employers and scheme members.

FUNDING STRATEGY STATEMENT

1. Introduction

This is the Funding Strategy Statement (FSS) of the Orkney Islands Council Pension Fund ("the Fund"), which is administered by Orkney Islands Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. This revised version replaces the previous FSS and is effective from 31 March 2009.

1.1 Regulatory Framework

Scheme members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level which covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The FSS forms part of a framework which includes:

- the Local Government Pension Scheme Regulations (Scotland) 1998 (regulations 75A and 76 are particularly relevant);
- the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's triennial valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions, provides recommendations to the Administering Authority when other funding decisions are required, for example when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

1.2 Reviews of FSS

The FSS is reviewed in detail at least every three years in parallel with the triennial valuations being carried out, with the next full review due to be completed by 31 March 2012. More frequently, Appendix A is updated to reflect any changes to employers.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Bryan Hay in the first instance at bryan.hay@orkney.gov.uk or on 01856 886307.

2. Purpose

2.1 Purpose of FSS

- *"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in Appendix B.

2.3 Aims of the Funding Policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund as a whole and the solvency of each of the notional sub-funds allocated to the individual employers;
- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue with consideration to the effect on the operation of their business where the Administering Authority considers this appropriate;
- to minimise the degree of short-term change in the level of each employer's contributions where the Administering Authority considers it reasonable to do so;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations; and
- to maintain the affordability of the Fund to employers as far as is reasonable over the longer term.

3. Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*[1], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a maximum period of 20 years.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer[2]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.5.

In effect, the *Common Contribution Rate* is a notional quantity. At present, all employers pay the same contribution rate. However, in the future separate future service rates may be calculated for each employer or pool together with individual past service adjustments according to employer or pool specific spreading and phasing periods.

Appendix A contains a breakdown of each employer's contributions following the 2008 valuation for the financial years 2009/10, 2010/11 and 2011/12. It includes a reconciliation of each employer's rate with the *Common Contribution Rate*. It also identifies which employers' contributions have been pooled with others.

Any costs of early retirements other than on the grounds of ill-health must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above (or by instalments shortly after the decision).

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off capital payments.

[1] See Regulation 76(4)
[2] See Regulation 76(6)

3.2 Solvency and Target Funding Levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund actuary's *ongoing funding basis*. This quantity is known as a funding level.

The ongoing funding basis is that used for each triennial valuation and the Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the administering authority.

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. Please refer to paragraph 3.8 for the treatment of departing employers.

3.3 Ongoing Funding Basis

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experiences of LGPS funds advised by the Fund Actuary. It is acknowledged that future life expectancy and in particular, the allowance for future improvements in mortality, is uncertain. Mortality assumptions have therefore been based on the PMA92 and PFA92 'year of birth' mortality tables with no allowance for any 'cohort effect', Employers should be made aware that their contributions are likely to increase in future if longevity exceeds the funding assumptions.

The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed statutory guarantee underpinning members' benefits. The demographic assumptions vary by type of member and so reflect the different profiles of employers.

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes allowance for anticipated returns from the Fund's assets in excess of gilts. There is, however, no guarantee that the assets held will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

In light of the statutory requirement for the Actuary to consider the stability of employer contributions it is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken. For the 2008 valuation, it is assumed that the Fund's equity investments will deliver an average additional return of 1.6% a year in excess of the return available from investing in index-linked government bonds at the time of the valuation. Based on the asset allocation of the Fund as at 31 March 2008, this is equivalent to taking credit for excess returns on equities of 2% p.a. over and above the gross redemptions yield on index-linked gilts on the valuation date and for excess returns of 0.4% p.a. on the non-equity assets.
The same financial assumptions are adopted for all ongoing employers. All employers have the same asset allocation.

3.4 Future Service Contribution Rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. At present, all employers pay the common contribution rate, however in the future if separate contribution rates are required, the approach used to calculate each employer's future service contribution rate will depend on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.4.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.4.2 Employers that do not admit new entrants

At the moment, all employers currently admit new entrants. If any Admission Bodies close the scheme to new entrants in the future, this is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long term stability to such employers' contributions, the *Attained Age* funding method will be adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Both future service rates will include an allowance for expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.5 Adjustments for Individual Employers

At present, all employers pay the common contribution rate, however in the future if separate contribution rates are required adjustments to individual employer contribution rates will be applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position. The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, part-time/full-time, manual/non manual);

- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;
- the effect of more or fewer withdrawals than assumed.

over the period between the 2005 and 2008 valuations and each subsequent triennial valuation period.

Actual investment returns achieved on the Fund between each valuation will be applied proportionately across all employers. Transfers of liabilities between employers within the Fund will occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary will not allow for certain relatively minor events occurring in the period since the last formal valuation including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.6 Asset Share Calculations for Individual Employers

At present, the Administering Authority does not account for each employer's assets separately. At future valuations, the Fund's actuary may be required to apportion the assets of the whole fund between the employers (or pools of employers) at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer (or pool).This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.7 Stability of Employer Contributions

3.7.1 Deficit Recovery Periods

The Administering Authority instructs the actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years.

This *maximum* period is used in calculating each employer's *minimum* contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2009 for the 2008 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.7.2 Surplus Spreading Periods

Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their **minimum** contributions.

However, to help meet the stability requirement, employers may prefer not to take such reductions.

3.7.3 Phasing in of Contribution Rises

Best Value Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises as follows:

- for employers contributing at or above its future service rate in 2008/09, phasing in the rise in employer contributions over a period of a maximum of three years;
- for employers contributing at less than its future service rate in 2008/09, phasing in the rise in employer contribution rises over a period of two years.

3.7.4 Phasing in of Contribution Reductions

Any contribution reductions will be phased in over six years for all employers except Best Value Admission Bodies who can take the reduction with immediate effect.3.7.5 The Effect of Opting for Longer Spreading or Phasing-In

Employers which are permitted and elect to use a longer deficit spreading period than was used at the 2005 valuation or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions will lead to higher contributions in the long-term.

However any adjustment is expressed for different employers the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

3.8 Admission Bodies ceasing

Admission Agreements for Best Value contractors are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until the last pensioner dies. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can however be terminated at any point.

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund actuary to carry out a special valuation to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

(a) For Best Value Admission Bodies, the assumptions would be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

(b) For non Best Value Admission Bodies that elect to voluntarily terminate their participation, the Administering Authority must look to protect the interests of other ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. This could give rise to significant payments being required.

(c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Bodies members and assets to the guarantor, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing Admission Body as a capital payment.

3.9 Early Retirement Costs

3.9.1 Non Ill Health retirements

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. All employers irrespective of whether or not they are pooled, are required to pay additional contributions wherever an employee "early" (see below) with no reduction to their benefit or receives an enhanced pension on retirement.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire. Members receiving their pension unreduced before this age other than on ill-health grounds are deemed to have retired "early".

The additional costs of premature retirement are calculated by reference to these ages.

3.9.2 Ill health monitoring

The Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non ill-health cases.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed from time to time, normally every three years, to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as equities and bonds. As at 31 March 2008, the proportion held in equities was 71% of the total Fund assets.

The investment strategy of lowest risk would be one which provides cashflows which replicate the expected benefit cashflows (i.e. the liabilities). Equity investment would not be consistent with this.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from a liability matching strategy. The Administering Authority's strategy recognises the relatively immature liabilities of the Fund and the secure nature of most employers' covenants.

The same investment strategy is currently followed for all employers. The Administering Authority does not currently have the facility to operate different investment strategies for different employers.

4.2 Consistency with Funding Basis

The funding policy currently adopts an asset outperformance assumption of 1.6% p.a. over and above the redemption yield on index-linked gilts. The Fund's actuary considers that the funding basis does conform to the requirements to take a "prudent longer-tem" approach to funding.

The Administering Authority is aware that, in the short term – such as the three yearly assessments at formal valuations – the proportion of the Fund invested in equities brings the possibility of considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of the outperformance target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.4 Intervaluation Monitoring of Funding Position

The Administering Authority monitors investment performance relative to the growth in the liabilities by means of annual interim valuations.

5. Key Risks & Controls

5.1 Types of Risk

The Administering Authority's has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial Risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress at three yearly valuations for all employers.* *Inter-valuation roll-forward of liabilities between formal valuations at whole fund level, provided on a annual basis*
Inappropriate long-term investment strategy	*Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.* *Consider measuring performance and setting managers' targets relative to bond based target, absolute returns or a Liability Benchmark Portfolio and not relative to indices* .
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	*Inter-valuation monitoring, as above.* *Some investment in bonds helps to mitigate this risk.*

Risk	Summary of Control Mechanisms
Active investment manager under-performance relative to benchmark	*Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.*
Pay and price inflation significantly more than anticipated	*The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases* . *Inter-valuation monitoring, as above, gives early warning.* *Some investment in index-linked bonds also helps to mitigate this risk.* *Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.*
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	*Seek feedback from employers on scope to absorb short-term contribution rises* . *Mitigate impact through deficit spreading and phasing in of contribution rises*

5.3 Demographic Risks

Risk	Summary of Control Mechanisms
Ill-health retirements significantly more than anticipated.	*Monitoring of each employer's ill-health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill-health assumptions built in.*
Pensioners living longer.	*Set mortality assumptions with some allowance for future increases in life expectancy.* *Fund actuary monitors combined experience of around 50 LGPS funds to look for early warnings of lower pension amounts ceasing than assumed in funding* *Administering Authority to encourage any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.*
Deteriorating patterns of early retirements	*Employers are charged the extra capital cost of non ill health retirements following each individual decision.* *Employer ill health retirement experience is monitored.*

5.4 Regulatory

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees</td><td rowspan="2">The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.

The Administering Authority considers all consultation papers issued by the ODPM and comments where appropriate.

The Administering Authority will consult employers where it considers that it is appropriate.

Copies of all submissions are available for employers to see at www.orkney .gov.uk
.</td></tr>
<tr><td>Changes to national pension requirements and/or HM Revenue & Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2007, abolition of 85 year rule and new 2009 scheme.</td></tr>
</table>

5.5 Governance

<table>
<tr><th>Risk</th><th>Summary of Control Mechanisms</th></tr>
<tr><td>Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).</td><td rowspan="2">The Administering Authority monitors membership movements on a quarterly basis, via a report from the administrator at quarterly meetings.

The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions if separate employer rates calculated in the future, (under Regulation 77) between triennial valuations

Deficit contributions are expressed as monetary amounts (see Appendix A).</td></tr>
<tr><td>Administering Authority not advised of an employer closing to new entrants.</td></tr>
<tr><td>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.</td><td>In addition to the Administering Authority monitoring membership movements on a quarterly basis, it requires employers with Best Value contractors to inform it of forthcoming changes.

It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.</td></tr>
<tr><td>An employer ceasing to exist with insufficient funding or adequacy of a bond.</td><td>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.
The risk is mitigated by:

• Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.
• Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</td></tr>
</table>

Risk	**Summary of Control Mechanisms**
An employer ceasing to exist with insufficient funding or adequacy of a bond (cont.)	• *Vetting prospective employers before admission.* • *Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.*

STATEMENT OF INVESTMENT PRINCIPLES

Statement of Investment Principles

This is the Statement of Investment Principles (the "Statement") required by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (the "2010 Regulations").

The Statement has been adopted by the Investment Sub Committee (the "Committee"), which acts on the delegated authority of the Orkney Islands Council, the administering authority for the Orkney Islands Council Pension Fund ("the Fund"). The Statement is subject to review from time to time and certainly within six months of any material change in investment policy or other matters as required by law. In preparing this Statement the Committee has consulted with the administrating authority and has taken and considered written advice from the Investment Practice of Hymans Robertson LLP.

Fund Objective

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, on a defined benefits basis.

The Committee aims to finance the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For members, benefits will be based on service completed but will take account of future salary increases.

This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

Investment Strategy

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund (details of which are set out in the Fund's CIPFA Adherence document, attached to this Statement). The strategic benchmark is reflected in the investment structure adopted by the Committee; this comprises a mix of segregated and pooled investments. The Fund benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.

The Committee monitors investment strategy relative to the agreed asset allocation benchmark. It is intended that investment strategy will be reviewed at least every three years following actuarial valuations of the Fund.

Limits on Investments

At the meeting on 21 December 2010, the Committee agreed to increase the limit on investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by one body, from 25% to 35% (the upper limit specified in Schedule 1 of the 2010 Regulations). Before taking this decision, the Committee took appropriate advice from its investment adviser, Hymans Robertson LLP, in relation to the impact of the increase on overall risk within the Fund and how the Committee monitors and manages that risk.

Limits on Investments (cont.)
The Committee made this decision on the basis that investment in the pooled funds concerned was effective both in terms of cost and in terms of broader portfolio diversification within the pooled funds concerned. The decision will be reviewed on a triennial basis or more frequently if required.

Types of investment to be held
The Fund may invest in quoted and unquoted securities of UK and overseas markets, including equities, fixed interest and index linked bonds, cash, property and commodities, either directly or through pooled funds.

The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products, for the purpose of efficient portfolio management or to hedge specific risks. The Committee considers all of these classes of investment to be suitable in the circumstances of the Fund.

The strategic asset allocation of the Fund includes a mix of asset types across a range of geographies in order to provide diversification of returns.

Balance between different kinds of investments
The Committee has appointed an investment manager who is authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed a specific benchmark with the manager so that it is consistent with the overall asset allocation for the Fund. The Fund's investment manager will hold a mix of investments which reflects its views relative to its respective benchmark. Within each major market and asset class, the manager will maintain diversified portfolios through direct investment or pooled vehicles.

Risk
The Fund is exposed to a number of risks which pose a threat to the Fund meeting its objectives. The principal risks affecting the Fund are:

<u>Funding Risk</u>

Financial mismatch – 1. The risk that Fund assets fail to grow in line with the developing cost of meeting Fund liabilities. 2. The risk that unexpected inflation increases the pension and benefit payments and the Fund assets do not grow fast enough to meet the increased cost.

Changing demographics –The risk that longevity improves and other demographic factors change increasing the cost of Fund benefits.

Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting Fund liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, it has set a strategic asset allocation benchmark for the Fund. It assesses risk relative to that benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. It also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

Funding Risk (cont.)

The Committee keeps under review mortality and other demographic assumptions which could influence the cost of the benefits. These assumptions are considered formally at the triennial valuation.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset Risk

Concentration - The risk that significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.

Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.

Manager underperformance - The failure by the fund manager to achieve the rate of investment return assumed in setting its mandate.

The Committee manages asset risks as follows. It provides a practical constraint on Fund investments deviating greatly from the intended approach by setting itself diversification guidelines and by investing in a range of investment approaches each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, constrains risk within the Committees' expected parameters. By investing across a range of assets, including quoted equities and bonds, the Committee has recognised the need for some access to liquidity in the short term. The decision to appoint only one investment manager does involve some degree of risk (from potential underperformance of that manager) which the Committee accept as a reasonable in the circumstances of the Fund.

Other Provider Risk

Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee takes professional advice and considers the appointment of specialist transition managers.

Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.

Credit default - The possibility of default of a counterparty in meeting its obligations.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers and audit of the operations they conduct for the Fund.

Expected return on investments

Over the long term, the overall level of investment returns is expected to exceed the rate of return assumed by the actuary in funding the Fund.

Realisation of investments

The majority of assets held by the Fund may be realised quickly if required.

Social, Environmental and Ethical Considerations
The Committee recognises that social, environmental and ethical considerations are among the factors which investment managers will take into account, where relevant, when selecting investments for purchase, retention or sale. The manager has produced statements setting out its policy in this regard. The manager has been delegated by the Committee to act accordingly.

Exercise of Voting Rights
The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by it with the objective of preserving and enhancing long term shareholder value. Accordingly, the manager has produced written guidelines of its process and practice in this regard. The manager is encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

Stock Lending
The policy on stock lending reflects the nature of the mandate awarded to the investment manager by the Committee, which includes both pooled and segregated holdings.
Within segregated mandates, the Committee has absolute discretion over whether stock lending is permitted. The Committee has considered its approach to stock lending, taking advice from its investment adviser. After consideration of that advice, the Committee has decided not to permit stock lending within any of its segregated investment mandates.

The manager may undertake a certain amount of stock lending on behalf of unit holders within its pooled fund holdings. Where a pooled fund engages in this activity, the extent to which it does is disclosed by the manager. The Committee has no direct control over stock lending in pooled funds; nevertheless, it is comfortable that the extent and nature of this activity is appropriate to the circumstances of the Fund.

The Committee reviews its policy on stock lending (including the amount and type of collateral used) on a regular basis.

Additional Voluntary Contributions (AVCs)
The Committee gives members the opportunity to invest in a range of vehicles at the members' discretion.

CIPFA Compliance
The Committee complies with the six principles set out in the Chartered Institute of Public Finance and Accountancy's publication, 'Investment Decision Making and Disclosure in the Local Government Pension Scheme – a guide to the application of the Myners Principles'.

STATEMENT OF COMPLIANCE WITH THE CIPFA PRINCIPLES OF INVESTMENT PRACTICE

Introduction
This document forms the Statement of Compliance with the Principles of Investment Practice as set out by CIPFA, the Chartered Institute of Public Finance Accountancy. It is maintained by Hymans Robertson LLP and the Director of Finance and Housing on behalf of the Investment Sub Committee ("the Sub Committee") of Orkney Islands Council.

This document was brought into force on 30 June 2003. The practices described within this document form the basis for investment decision making by the Sub Committee. This document is reviewed from time to time, and is made available to members on request. Details of version control and changes are provided in the Appendix A to this document.

The document also provides information on all of the Fund's investment service providers (investment manager(s), custodian(s), adviser(s), etc.) along with details of the nature of the services they provide and how their performance in these roles is assessed.

This is current version of the document (2010 V5) was agreed by the Committee Members in December 2010.

1. EFFECTIVE DECISION MAKING

Principle
Administering authorities should ensure:

That decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and

That those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.

Orkney Islands Council
The Council is responsible for the following activities:

The Council will determine the allocation of new money to the manager. Similarly, in the event that assets need to be realised in order to meet the Fund's liabilities, the Council will determine the source of this funding.

The Council will be responsible for any changes to the terms of the mandates of existing managers.

The Council will be responsible for the appointment and termination of managers.
The Council is responsible for socially responsible investment, corporate governance and shareholder activism. It has delegated these tasks to the Fund's managers, who conduct the delegated tasks in line with the Council's policies.

The Council will be responsible for the appointment and termination of AVC providers.

The Council is responsible for maintenance of the Statement of Investment Principles (SIP) and the document setting out the Fund's CIPFA Principles of Investment Practice disclosure.

The Council has delegated the Fund's monitoring responsibilities to the Investment Sub Committee.

Investment Sub Committee Terms of Reference
The Sub Committee is responsible for monitoring all aspects relating to the investment of the assets of the Fund. Their specific responsibilities are as follows:

The Sub Committee will formally review the Fund's asset allocation at least annually, taking account of any changes in the profile of Fund liabilities and any guidance regarding tolerance of risk. They will recommend changes in asset allocation to the Council.

The Sub Committee will consider and monitor the Quarterly Reports produced by their Investment Manager. In addition to managers' portfolio and performance reporting, the Sub Committee will also receive and review information from the managers on risk analysis, transaction costs, and details of corporate governance (including SRI, voting activity and engagement with management).

The Sub Committee will formally review annually the manager's mandate, and its adherence to its expected investment process and style. The Sub Committee will ensure that the explicit written mandate of each of the Fund's managers is consistent with the Fund's overall objective and is appropriately defined in terms of performance target, risk parameters and timescale.

The Sub Committee will consider the need for any changes to the Fund's investment manager arrangements (e.g. replacement, addition, termination) at least annually.

In the event of a proposed change of managers, the Sub Committee will evaluate the credentials of potential managers.

The Sub Committee will consider the Fund's approach to social, ethical and environmental issues of investment, corporate governance and shareholder activism.

The Sub Committee will review the Fund's AVC arrangements annually. If they consider a change is appropriate, they will make recommendations to the Council.

The Sub Committee will monitor the investment advice from their investment consultant and investment services obtained from other providers (e.g. custodian) at least annually. The Sub Committee will be responsible for the appointment and termination of providers.

The Sub Committee will conduct and conclude the negotiation of formal agreements with managers, custodians and other investment service providers.

In order to fulfil their roles, the members of the Sub Committee will be provided with appropriate training, initially and on an ongoing basis.

The Sub Committee is able to take such professional advice as it considers necessary.

The Sub Committee will keep Minutes and other appropriate records of its proceedings, and circulate these Minutes to the Council.

The Sub Committee may also carry out any additional tasks delegated to it by the Council.

Any changes to the membership of the Sub Committee require the approval of the Council.

Membership of the Sub Committee consists of a minimum of five members with a quorum of three members. All Sub Committee members are expected to have or, for new members, to develop sufficient expertise in investment matters to be able to conduct their Sub Committee responsibilities and to interpret the advice which they receive.

Other Delegated Investment Decisions
Delegation to Officers
Preparation of annual budgets and business plan for the Fund

Delegation to Investment Manager
Day to day management of the Fund's investment portfolios and related activities has been delegated to the Fund's investment manager, Baillie Gifford. This includes:

Investment of the Fund's assets.

Tactical asset allocation around the Fund's strategic benchmark.

Preparation of quarterly reporting including a review of investment performance.

Attending meetings of the Investment Sub Committee.

Providing Fund accounting data concerning the investment portfolio and transactions.

Delegation to Custodian
The Custodian is responsible for settlement of all investment transactions, collection of income, tax reclaims and corporate action administration.

Actuary to the Fund
The Actuary is responsible for
Undertaking a triennial valuation of the Fund's assets and liabilities.

Setting the Fund's contribution rate.

Providing advice on the funding level and maturity of the Fund which the Investment Sub Committee can take into consideration when balancing the Fund's investment and funding objectives.

Expert Advice
The Sub Committee receives investment and actuarial advice from Hymans Robertson LLP. These appointments were made on 1 April 2004.

At the time of appointment of consultants, the Sub Committee did not invite tenders for actuarial and investment advice separately. The Sub Committee will arrange for separate competition when it next tenders either activity.

At present there are no separate contracts in place.

Other Advice
In addition to the investment consultant, the Sub Committee also seeks advice (where relevant) from the Fund's Actuary and the Council's Director of Finance and Housing.

There are no independent advisers appointed to the Investment Sub Committee.

Assessment of Advice
All advice is assessed as described in Section 4.

2. INVESTMENT OBJECTIVE

Principle
An overall investment objective should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.

Fund Objective
The Fund is a Local Government Pension Scheme (LGPS).

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. Benefits for active members increase in line with salaries. Benefits for preserved members are subject to statutory increases.

The Council aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer (Orkney Islands Council) to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary increases.

Basis of Evaluation
An actuarial valuation of the Fund is conducted at least every three years in accordance with the LGPS regulations. The last actuarial valuation was conducted as at 1 April 2008, and the results became available in March 2009. The results disclosed an ongoing funding level of 86%.

The position of the Fund is monitored each year in consultation with the employers and the Actuary.

Strategic Asset Allocation and Manager Structure
The Fund's investment manager arrangements are summarised in Table 5.1 below:

Manager	Appointed	Brief	%
Baillie Gifford	April 1995	Multi-asset	100

Custody
The Fund's custodian is the Bank of New York Mellon.

Baillie Gifford
Baillie Gifford's mandate was formally reviewed in April 2006. The detail of the investment structure has recently been reviewed in December 2010. The benchmark and range guidelines that will apply from the start of 2011 are shown in Table 5.2. Baillie Gifford's benchmark mirrors the Scheme benchmark. Baillie Gifford's target is to outperform the WM Local Authority benchmark ex property (re-balanced quarterly) by 1% p.a. when assessed over rolling 5 year periods, with effect from 1 July 2006.

Asset Class	Range (%)	Central benchmark (%)
Total Equities	50-90	WM Local Authority ex property weighted average allocations for each asset class
UK Equities	20-50	
Overseas Equities	25-55	
Total Bonds	10-30	
Alternatives	0-20	
Cash	0-5	
Composite	WM LA Median ex property	100

Baillie Gifford manages the fund in line with the LGPS regulations. There are no restrictions in Baillie Gifford's agreement which prevents it from investing in any financial instrument permitted in these regulations, except to the extent that derivative instruments may only be used on a segregated basis for the purposes of risk reduction and efficient portfolio management.

The Sub Committee recognises that the pursuit of superior performance through active management also carries the risk of underperformance. However, they believe and the manager accepts that the range guidelines set will contain risk within the tolerance that the Sub Committee deems acceptable.

The Sub Committee has considered the extent to which their managers expect to achieve outperformance through stock and sector selection and asset allocation.

They have considered the risks associated with stock and sector concentration in each of the markets in which they invest.

Baillie Gifford provides details on its level of turnover and commission levels on a quarterly basis. The Sub Committee will monitor Baillie Gifford's transaction costs (every 6 months) (in line with the transaction cost reporting framework of the Fund Management Association with which the Baillie Gifford complies).

Baillie Gifford does not make use of soft commission arrangements.

The Sub Committee takes advice from its investment consultant relating to Baillie Gifford's transaction costs.

Benchmarks
Since only one manager is employed, the Scheme and investment manager share the same benchmark.

The benchmark is used:

To evaluate the manager's relative performance

To monitor the extent of the manager's deviations from benchmark performance

To specify the limits on manager's asset allocation deviations (specified by size of active bets and aggregate tracking error).

At the asset class level, the manager's activity is assessed relative to specific stock market indices (e.g. the FTSE All-Share index for UK equities).

The Sub Committee also considers returns relative to peer group benchmarks, such as the WM Local Authority universe, for comparing the general performance of the Scheme and its asset allocation benchmark, recognising that its asset liability structure may differ.

The use of benchmarks for assessing managers, providers, officers and the Sub Committee is discussed in Section 4.

Benchmark Indices
The Sub Committee discusses the appropriateness of the asset class indices with its investment manager and investment consultant on an annual basis. The review takes account of changes in the constituency of indices, their degree of concentration, changes made by index providers, new classes of assets, and changes in the profile of liabilities which may affect the duration of bond indices.

Benchmark Indices (Cont.)
The Sub Committee recognises that the setting of benchmark targets can encourage managers to closet index, i.e. to hug the index too closely to be able to deliver the performance target set. The Sub Committee has discussed this subject with its manager and investment consultant. In setting tracking error guidelines, the Sub Committee has indicated limits to its manager so that the risk it takes is consistent (i.e. neither too little or too great) in relation to its performance target. The Sub Committee monitors the manager's tracking error (see Section 4).

Investment Structure
The Sub Committee has considered its investment structure, the choice between active and passive management, and the number of managers it might employ, and where risk might best be exploited.

It employs a single active manager who is responsible for all of the asset classes within the benchmark and for asset allocation around that benchmark within the guideline ranges set. In choosing a single active multi-asset manager, the Sub Committee has considered, and is prepared to tolerate the potential risks associated with that manager's pursuit of outperformance.

3. RISK AND LIABILITIES

Principle
In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.

These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

Basis for Determining Fund Benchmark
The Benchmark of the Fund is the WM Local Authority ex property benchmark. This is a peer group benchmark. The Sub Committee has not formally considered the adoption of a benchmark which is bespoke to the circumstances of the fund.

The asset mix takes account of diversification between asset classes.

The Investment Manager has its own individual benchmark as outlined above. The manager's benchmark is consistent with the Scheme benchmark.

Risk
The return assumptions required to achieve and maintain the Fund Objective are set out in the Actuarial Valuation. The benchmark adopted by the Sub Committee for the Fund is designed to achieve that return over the long term. The Sub Committee recognises that there will be periods when market conditions do not permit those assumptions to be met and that the benchmark needs to be kept under periodic review in order to confirm that it is still suitable for the purpose for which it was designed.

Asset Classes
In setting the Scheme benchmark, the Sub Committee considered all the principal asset classes listed in the CIPFA Guidance.

Periodic Review
The Sub Committee most recently reviewed the Fund benchmark at their meeting in December 2010.

4. PERFORMANCE ASSESSMENT

Principle
Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.

Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.

Investment managers
Baillie Gifford provides summary and detailed portfolio valuations, consolidated transaction reports and balance sheet and income statements on a quarterly basis. It also provides details of performance at the individual asset class and aggregate level. The Sub Committee obtains independent measurement of returns from a specialist agency.

Manager Monitoring Activity
The Sub Committee monitors the relative and absolute performance of its investment manager, Baillie Gifford, on a quarterly basis. However, it reviews Baillie Gifford's performance more formally once a year. This review considers not only investment returns but also an assessment of Baillie Gifford's adherence to its mandate requirements including the full range of activities delegated to them. The Sub Committee also considers the manager's investment process, stability of key personnel and market position.

Baillie Gifford reports its performance, its active asset allocation positions relative to benchmark and its *ex ante* tracking error within UK equities on quarterly basis. Baillie Gifford also reports active positions at the sector and stock level within UK equities.

Investment Consultant Monitoring Activity
The Sub Committee monitors performance of its investment consultant, Hymans Robertson, largely on a qualitative basis. The consultant provides guidance on asset allocation, benchmark setting, risk and goal setting of the investment manager, manager monitoring and general information on legislation, industry background and securities markets (all from an investment perspective). To date, the investment consultant has not provided advice on manager selection.

Sub Committee and Officers
The Sub Committee reviews the investment decisions undertaken by officers and by the Sub Committee, to check their appropriateness and whether outcomes might have been improved. This includes:

How the overall Fund benchmark has performed relative to liabilities and relative to its comparable LGPS peers.

How the Sub Committee interpreted advice provided by the investment consultant.

Sub Committee recommendations and Council decisions undertaken over year concerning service provider and manager changes, benchmark changes, mandate changes, and transitions between mandates.

5. RESPONSIBLE OWNERSHIP

Principle
Administering authorities should:

adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.

include a statement of their policy on responsible ownership in the Statement of Investment Principles.

report periodically to scheme members on the discharge of such responsibilities.

Governance and Voting
The Council has delegated the following tasks to the investment manager.

Engaging with companies in which the Fund invests concerning corporate governance issues.

The exercises of voting rights on the basis that voting power will be exercised by the manager with the objective of preserving and enhancing long term shareholder value.

Accordingly, Baillie Gifford has produced written guidelines of its process and practice in both matters.

Baillie Gifford is encouraged to vote in line with its guidelines in respect of all resolutions at annual and extraordinary general meetings of companies.

Engagement and Activism
Baillie Gifford has disclosed its own policy on corporate governance, engagement and activism which it exercises on behalf of client's investment mandates when the client has delegated responsibility for these activities to Baillie Gifford. It votes proxies on behalf of the Fund and engages with the UK companies (and larger international companies) in which it invests. Baillie Gifford reports its voting activity to the Sub Committee each quarter on an exceptions basis, i.e. it does not include non controversial items such as re-appointment of directors.

In general, Baillie Gifford does not intervene in companies, except in unusual circumstances and then generally as part of an investment industry grouping. The Sub Committee accepts that it is not in the economic interests of the Fund for its manager to intervene more generally.

6. TRANSPARENCY AND REPORTING

Principle
Administering authorities should:

act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.

should provide regular communication to scheme members in the form they consider most appropriate.

Approach
This document should be read in conjunction with the Fund's Statement of Investment Principles. Taken together, these documents provide the framework for the Fund's investment operations.

Section 1 of this document describes the structure for making investment decisions for the Fund, the split of responsibilities among the Council, Investment Sub Committee, Investment Manager, Custodian, Scheme Actuary, Investment Consultant and other providers.

Sections 2 describes the roles and mandates of external providers (consultant, investment manager, etc).

Other Advice
In addition to the investment consultant, the Sub Committee also seeks advice (where relevant) from the Fund's Actuary and the Council's Director of Finance and Housing.

There are no independent advisers appointed to the Investment Sub Committee.

Assessment of Advice and Decision Making
All advice and decision making is assessed as described in Section 4.

Regular Reporting
The Council makes the following documents available to Fund members on request.

The Statement of Investment Principles.

Details of the Fund's adoption of the CIPFA Principles of Investment Practice (i.e. this document).

Both documents are revised periodically, in any event, and when changes occur.

An abbreviated version of this document is sent to Fund members annually.

Version Control Record
Table of Amendments
The attached Table records changes to this document.

Version	Nature of Change	Implemented
2003 V1	Initial Creation	30 June 2003
2004 V2	Final Document	31 October 2004
2007 V3	Benchmark change	10 July 2007
2009 V4	Review document	30 June 2009
2010 V5	Update following structure change and consolidation on principles from 10 to 6	21 December 2010

SUMMARY OF ACTUARIAL VALUATION AS AT 31 MARCH 2008

	£000	£000
Past service Liabilities		
Active Members	81,204	
Deferred Pensioners	13,976	
Pensioners	32,984	
Value of Scheme Liabilities		**128,164**
Deficit		(17,622)
Assets		**110,542**
Funding Level		**86%**

In accordance with the Funding Strategy Statement the administering authority has adopted a stepped increase in employer contributions over 3 years to achieve the identified employer contribution rate of 21.4%, as follows:

2009/10 18.4%
2010/11 20.4%
2011/12 21.4%

Employers Contributions as a % of Pensionable Payroll	
Total Future Service cost	24.0%
Employee Contributions (Excluding AVCs)	6.5%
Expenses	0.6%
Net Employer Future Service Cost	18.1%
Past Service Adjustment - 20 Year Spread	3.3%
Employer Contribution Rate	21.4%

The actuarial present value of promised retirement benefits can be compared to the net assets of the Pension Fund as Follows:-

	2009/10	**2010/11**
	£m	**£m**
Present Value of Promised Retirement Benefits	191	**173**
Net Assets of the Pension Fund	138	**160**
Surplus/(Deficit)	(53)	**(13)**

Liabilities have been projected using a roll forward approximation from the latest formal valuation as at 31 March 2008. The Actuary estimates this liability at 31 March 2011 comprises £124m in respect of employee members, £17m in respect of deferred pensioners and £32m in respect of pensioners. Also, the actuary estimates this liability at 31 March 2010 comprises £135m in respect of employee members, £20m in respect of deferred pensioners and £36m in respect of pensioners. The approximation involved in the roll forward model means that the split of scheme liabilities between the three classes of member may not be reliable. The actuary are satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. The actuary has not made any allowances for unfunded benefits.

Financial Assumptions

	31 March 2010 % p.a.	**31 March 2011 % p.a.**
Inflation / Pension Increase Rate	3.8%	**2.8%**
Salary Increase Rate	5.3%	**5.1%**
Discount Rate	5.5%	**5.5%**

The salary increase assumption for 31 March 2011 is 1% p.a. for two years the 5.1% p.a.

<u>Mortality</u>

Life expectancy is based on the PMA92/PFA92 year of birth tables, with improvements from 2007 in line with the medium cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

	Males	**Females**
Current Pensioners	21.5 years	24.9 years
Future Pensioners*	23.5 years	27.0 years

*Future pensioners are assumed to be currently aged 45

<u>Historic Mortality</u>

Life expectancy for all of the below year ends is based on the PFA92 and PMA92 tables. The actuary shows the allowance for future life expectancy in the following table:

Year Ended	**Prospective Pensioners**	**Pensioners**
31 March 2010	year of birth, medium cohort and 1% p.a. minimum improvements from 2007	year of birth, medium cohort and 1% p.a. minimum improvements from 2007

Age ratings and loadings are applied to the above tables based on membership profile.

ORKNEY ISLANDS COUNCIL PENSION FUND ACCOUNTS

FUND ACCOUNT	**2009/10**	**2010/11**
Contributions Receivable	£'000	**£'000**
Employer Contributions - Normal	5,909	**6,647**
Employer Contributions - Additional	122	**50**
Employees Contributions - Normal	2,091	**2,146**
Transfers In - Individual Transfers in from Other Schemes	439	**393**
TOTAL CONTRIBUTIONS RECEIVABLE	**8,561**	**9,236**
Benefits Payable		
Pensions	2,827	**2,935**
Commutation of Pensions and Lump Sum Retirement Benefits	731	**973**
Lump Sum Death Benefits	81	**138**
Refund of Contributions	20	**18**
State Scheme Premiums	8	**8**
Transfers Out - Group Transfers out to Other Schemes	0	**0**
Transfers Out - Individual Transfers out to Other Schemes	873	**205**
Fund Administration	221	**251**
TOTAL BENEFITS PAYABLE	**4,761**	**4,528**
NET ADDITIONS FROM DEALING WITH MEMBERS	**3,800**	**4,708**
Returns on Investments		
Investment Income:-		
Interest from Fixed Interest Securities	207	**255**
Dividend from Equities	2,304	**2,884**
Income from Index Linked Securities	140	**119**
Income from Pooled Investment Vehicles	939	**824**
Interest on Cash Deposits	18	**19**
Recoverable Tax	18	**18**
Gain in Market Value of Investments:		
Realised	12	**31,792**
Unrealised	38,502	**(18,124)**
Irrecoverable Withholding Tax	(194)	**(223)**
Investment Management Expenses	(309)	**(366)**
NET RETURN ON INVESTMENTS	**41,637**	**17,198**
NET INCREASE IN FUND DURING YEAR	**45,437**	**21,906**
Opening Net Assets of Fund at 1 April	92,936	**138,373**
Net Increase/(Decrease) in Fund During the Year	45,437	**21,906**
CLOSING NET ASSETS OF FUND	**138,373**	**160,279**

ORKNEY ISLANDS COUNCIL PENSION FUND ACCOUNTS

NET ASSETS STATEMENT AS AT 31 MARCH		
Investment Assets	**2009/10**	**2010/11**
Fixed Interest - Public Sector	4,612	**3,528**
Fixed Interest - Other	321	**88**
Index Linked - Public Sector	7,489	**5,547**
Index Linked - Other	0	**0**
Equities - Quoted	91,972	**119,200**
Pooled Investment Vehicles - Other Managed Funds	29,307	**24,809**
Funds held by Investment Managers - Other (Cash)	5,255	**6,531**
TOTAL INVESTMENT ASSETS	**138,956**	**159,703**
Current Assets		
Sundry Debtors	0	**0**
Loans Fund Deposit	0	**794**
Less Current Liabilities		
Sundry Creditors	86	**218**
Loans Fund Advance	497	**0**
NET CURRENT ASSETS	**(583)**	**576**
NET ASSETS	**138,373**	**160,279**
Financed by :		
ACCUMULATED FUND	**138,373**	**160,279**

The unaudited accounts were issued on the 30 June 2011 and the audited accounts were authorised for issue on 30 September 2011.

Gareth Waterson, BAcc, CA
Director of Finance & Housing
Orkney Islands Council
30 September 2011

STATEMENT OF PRINCIPAL ACCOUNTING POLICIES

1 Basis of Preparation

The accounts for the Fund have been prepared in accordance with the main recommendations of the CIPFA Code of Practice on Local Authority Accounting and International Accounting Standard 26, with the exception of transfer values, which are credited in the year they are received. All transfer values paid, and the service credit given in exchange for transfer values received, are calculated in accordance with the Scheme's regulations and are consistent with the requirements of Schedule 1A of the Social Security Pensions Act.

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 the Accounts and should be read in conjunction with the actuary's report.

2 Investments

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

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

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

c Unlisted investments, which comprise the Fund Manager's Unit Trusts and Open Ended Investment Companies, are valued at middle market prices on the last working day of the financial year as supplied by the Fund Manager.

3 Debtors and Creditors

The accounts have been prepared on an accruals basis; that is income and expenditure is included as it is earned or incurred, not as it is received or paid, except for Transfer Values which are included when they are paid or received.

4 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.

5 Foreign Currency

Income and expenditure arising from transaction denominated in a foreign currency should be 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 should be used.

6 Investment Management Expenses

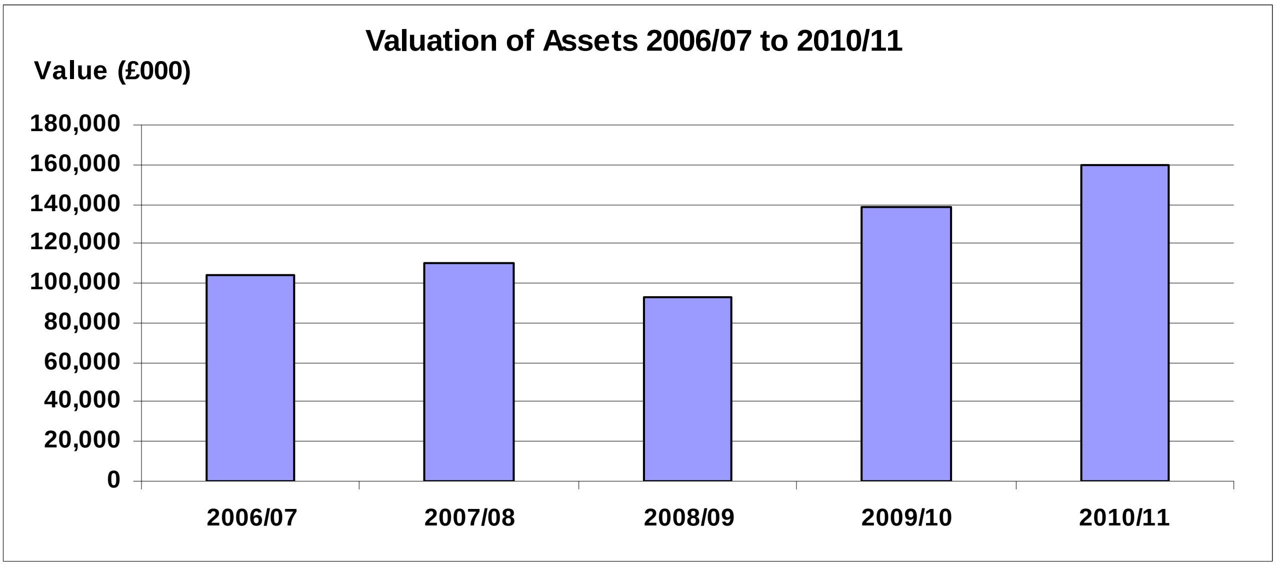
Investment Management expenses consist of direct charges in line with Management Agreements, Management Charges levied on pooled funds, overseas charges and non-recoverable withholding tax.

7 Acquisition Cost

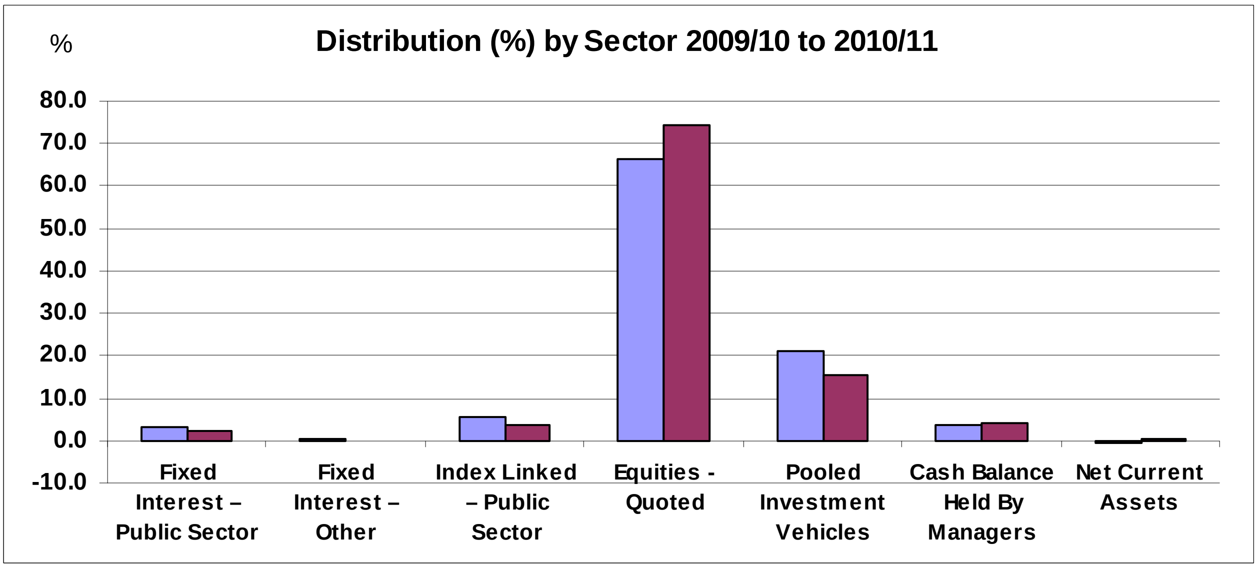
Any acquisition cost of investment, are included in the Book Cost of the investment.

VALUATION AND DISTRIBUTION OF ASSETS OF THE PENSION FUND

	2006/07	2007/08	2008/09	2009/10	2010/11
	£000	£000	£000	£000	£000
Value at start of Year	96,122	103,879	110,542	92,936	138,373
Movement in Year	7,757	6,663	(17,606)	45,437	21,906
Value at End of Year	**103,879**	**110,542**	**92,936**	**138,373**	**160,279**



	Valuation (£000) and Distribution (%)			
	31/03/2010		31/03/2011	
Sector	**£000**	**%**	**£000**	**%**
Fixed Interest – Public Sector	4,612	3.3	3,528	2.2
Fixed Interest – Other	321	0.2	88	0.1
Index Linked – Public Sector	7,489	5.4	5,547	3.5
Equities - Quoted	91,972	66.5	119,200	74.3
Pooled Investment Vehicles	29,307	21.2	24,809	15.5
Cash Balance Held By Managers	5,255	3.8	6,531	4.1
Net Current Assets	(583)	(0.4)	576	0.3
Totals	**138,373**	**100.0**	**160,279**	**100.0**



INVESTMENT PERFORMANCE

Introduction

The proportion of the funds under management at 31 March 2011 along with comparable 2010 figures was as follows:

	2009/10		**2010/11**	
	£'000	%	**£'000**	**%**
Baillie Gifford and Company	138,956	100.42	**159,703**	**99.64**
Loans Fund Advance	(497)	(0.36)	**0**	**0.00**
Loans Fund Deposit	0	0.00	**794**	**0.50**
Sundry Debtors Less Creditors	(86)	(0.06)	**(218)**	**(0.14)**
Totals	138,373	100.0	**160,279**	**100.0**

Details of the investment assets between UK or Foreign, and listed or unlisted are set out below:

	2009/10	**2010/11**
	£'000	**£'000**
UK Listed	94,648	**76,756**
UK Unlisted	0	**0**
Foreign Listed	44,308	**82,947**
Foreign Unlisted	0	**0**
	138,956	**159,703**

One of the investments held by the Pension Fund exceeds 5% of the total value of assets:

		2010/11
Company	**Nature of Investment**	**£'000**
Baillie Gifford & Company	Open Ended Investment Company	**15,407**

Investment Movement Summary:

	Value at 1 April 2010 £'000	**Purchases at Cost £'000**	**Sales Proceeds £'000**	**Change in Market Value £'000**	**Value at 31 March 2011 £'000**
Fixed Interest - Public Sector	4,612	7,452	(8,479)	(57)	**3,528**
Fixed Interest - Other	321	0	(207)	(26)	**88**
Index Linked - Public Sector	7,489	8,027	(9,156)	(813)	**5,547**
Index Linked - Other	0	0	0	0	**0**
Equities - Quoted	91,972	81,594	(46,919)	(7,447)	**119,200**
Pooled Investment - Other	29,307	17,237	(11,783)	(9,952)	**24,809**
Cash Deposits	5,255	0	0	1,276	**6,531**
	138,956	**114,310**	**(76,544)**	**(17,019)**	**159,703**

Investment Movement Summary (cont.)

Transaction costs are included in the cost of purchases and sale proceeds. These include costs charged directly to the Fund such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £208K (2009/10 £143K). In addition to the transaction costs disclosed above, indirect costs may be incurred through the bid-offer spread on some pooled investment vehicles, the amount of any such costs is not separately provided to the fund.

Contributions Receivable and Benefits Payable

An analysis is provided below for the Orkney Islands Council Pension Fund of contributions receivable and benefits payable between the administering authority and admitted bodies.

	2009/10	**2010/11**
Administering Authority :	£'000	**£'000**
- Contributions Receivable	7,177	**7,885**
- Benefits Payable	3,377	**3,688**
Admitted Bodies		
-Contributions Receivable	823	**908**
-Benefits Payable	262	**358**
Combined Totals		
-Contributions Receivable	8,000	**8,793**
-Benefits Payable	3,639	**4,046**

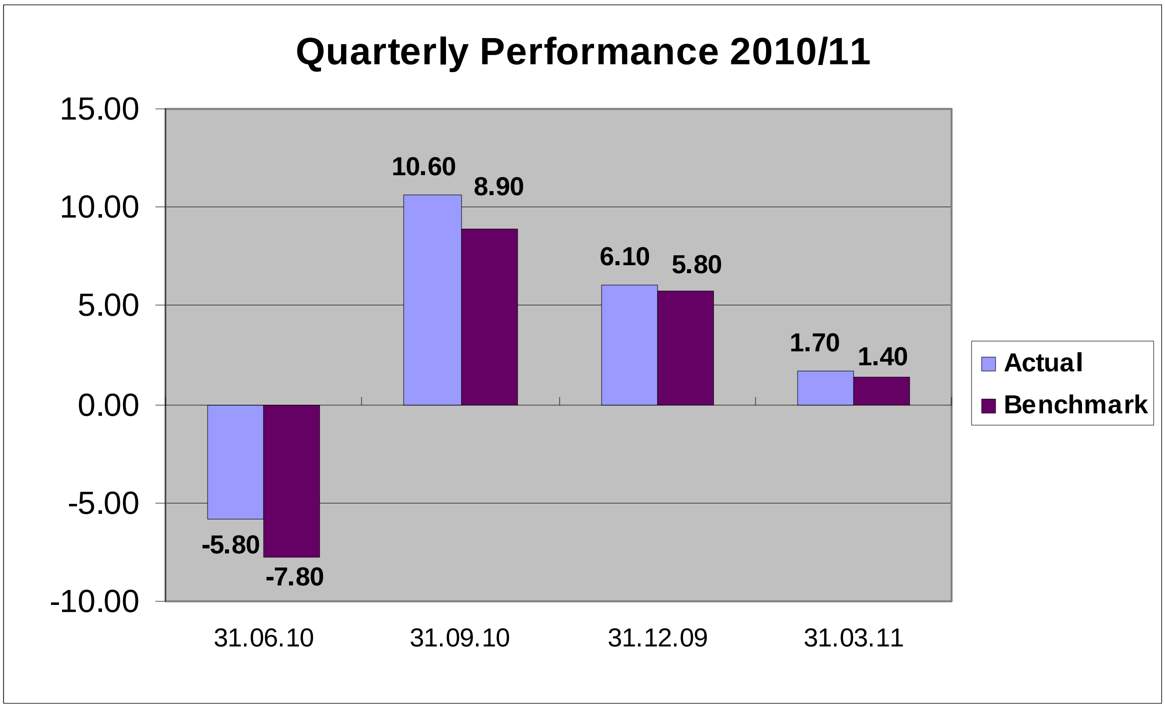
Market Value of Funds

The market value of investments can go down, as well as up. The total market value of the investments that are under external management was £159.7m as at 31 March 2011.

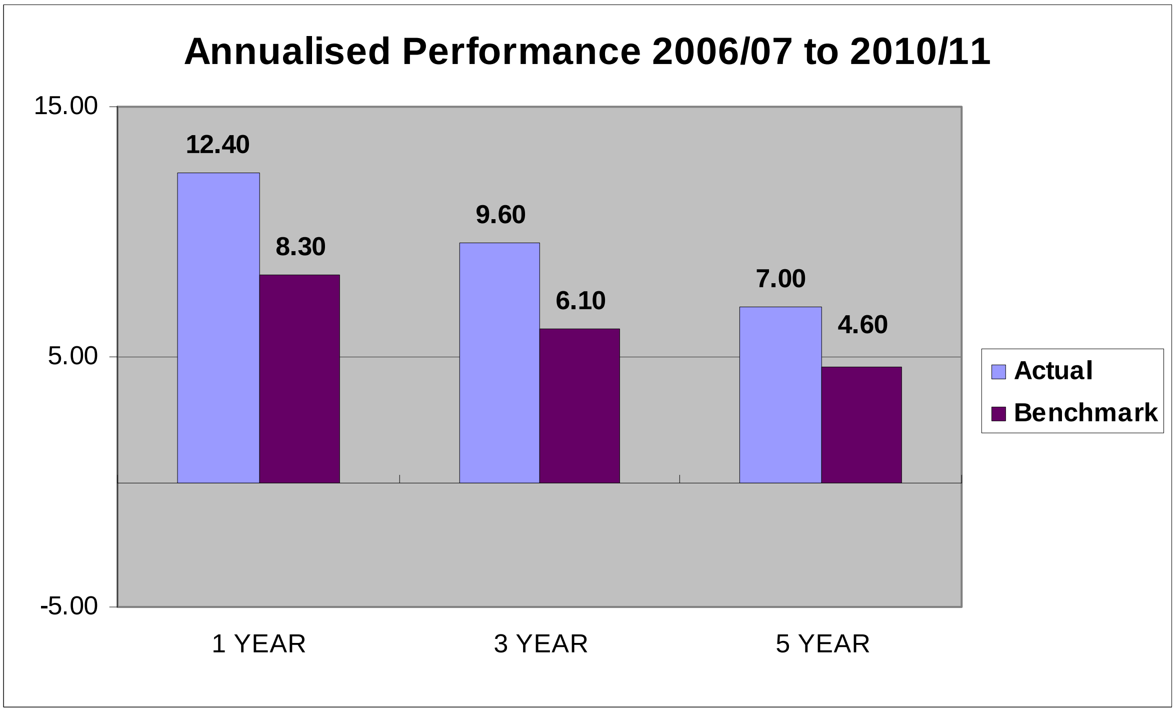
Performance against Benchmark

Three times a year, the Council's Investment Sub-Committee convenes to review the performance of the investments made with the Funds. In that connection, the Council engages WM Company to produce performance measurement statistics for the Fund.

On a quarterly basis the fund has consistently out performed the benchmark for the year to 31 March 2011.



On a annualised basis this translates into a consistent gain over the 1 year, 3 year and 5 year period as follows:-



ACTUARY'S STATEMENT

This statement has been prepared in accordance with Regulation 31A of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2010/11.

Description of Funding Policy

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

- to ensure the long-term solvency of the Fund as a whole and the solvency of each of the notional sub-funds allocated to the individual employers;
- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue with consideration to the effect on the operation of their business where the Administering Authority considers this appropriate;
- to minimise the degree of short-term change in the level of each employer's contributions where the Administering Authority considers it reasonable to do so;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations; and
- to maintain the affordability of the Fund to employers as far as is reasonable over the longer term.

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2008. This valuation revealed that the Fund's assets, which at 31 March 2008 were valued at £110.5 million, were sufficient to meet 86% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2008 valuation was £17.6 million.

Individual employers' contributions for the period 1 April 2009 to 31 March 2012 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 my valuation report dated 27 March 2009.

Method

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

Assumptions

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

The key financial assumptions adopted for the 2008 valuation were as follows:

Financial assumptions	31 March 2008	
	% p.a. Nominal	% p.a. Real
Discount rate	6.1%	2.5%
Pay increases *	5.1%	1.5%
Price inflation/Pension increases	3.6%	-

* Plus an allowance for promotional pay increases.

The key demographic assumption was the allowance made for longevity. The longevity assumptions adopted at this valuation were in line with standard PXA92 year of birth mortality tables. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	20.7 years	23.8 years
Future Pensioners	22.0 years	25.0 years

Copies of the 2008 valuation report and Funding Strategy Statement are available on request from Orkney Island Council, administering authority to the Fund.

Experience over the period since April 2008

The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced as at 31 March 2011. It showed that the funding level (excluding the effect of any membership movements) has improved since the 2008 valuation to 100% at 31 March 2011. However, this does not take account of actual experience since 2008 and so may not reflect the true underlying position of the Fund.

The next actuarial valuation will be carried out as at 31 March 2011. The Funding Strategy Statement will also be reviewed at that time.

Barry McKay
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
30 September 2011

Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

PRINCIPLE EQUITY HOLDINGS (TOP TEN BY VALUE)
AS AT 31 MARCH 2011

Investment	Value £'000	% of Total Equity Holding	Activities
iShares MSCI Brazil IDX FD	2,911	2.4	MSCI Brazil Exchange Fund
Prudential	2,791	2.3	Life Insurer
Svenska Handelsbanken	2,287	1.9	Swedish Bank
Nestle	2,221	1.9	Swiss Food Producer
Wolseley	2,119	1.8	Builders Merchant
Atlas Copco B	2,073	1.7	Industrial Mining Equipment
Schindler PC	2,063	1.7	Swiss Manufacturer
HSBC	1,944	1.6	International Bank
Yamaha Motor	1,897	1.6	Motor Vehicles
DBS Group Holdings Ltd	1,828	1.5	Singapore Bank
Totals	**22,134**	**18.4**	
Total Value of Equities	**119,200**		
Total Value of Funds	**159,703**		

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

We certify that we have audited the financial statements of Orkney Islands Council Pension Fund for the year ended 31 March 2011 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund account, the net assets statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the 2010/11 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 123 of the Code of Audit Practice approved by the Accounts Commission for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Director of Finance & Housing and auditor

As explained more fully in the Statement of Responsibilities set out on page 2, the Director of Finance & Housing is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance & Housing; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2010/11 Code of the financial transactions of the fund during the year ended 31 March 2011, and of the amount and disposition at that date of its assets and liabilities;

- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 Code; and

- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In our opinion the information given in the Explanatory Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers

We have nothing to report in respect of these matters.

Scott-Moncrieff
Chartered Accountants
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

30 September 2011

APPENDIX A

EMPLOYERS' CONTRIBUTIONS, SPREADING AND PHASING PERIODS

At present, all employers pay the same contribution rate. Following the 2008 valuation, the minimum employer contributions shown in the Rates and Adjustment certificate attached to the 2008 valuation report are based on the deficit recovery periods and phasing periods shown in the table below.

Employer Code	Employer	Minimum contributions for the year ending			Deficit spread period (years)	Phasing Period (years)
		31 March 2010	31 March 2011	31 March 2012		
1	Orkney Islands Council	18.4%	20.4%	21.4%	20	3
5	Orkney Tourist Board	18.4%	20.4%	21.4%	20	3
7	Orkney Towage Company Limited	18.4%	20.4%	21.4%	20	3
9	Orkney Meat Limited	18.4%	20.4%	21.4%	20	3
10	Orkney Ferries Limited	18.4%	20.4%	21.4%	20	3
11	Orkney Enterprise	18.4%	20.4%	21.4%	20	3
14	Pickaquoy Centre Trust	18.4%	20.4%	21.4%	20	3
16	Orkney Islands Property Development Ltd	18.4%	20.4%	21.4%	20	3
Employers with No Active Members						
6	Orkney Heritage Society					
8	Weyland Farms Limited					
12	Orkney Opportunities Centre					
13	Drinkwise Orkney					
15	D & H Glue					

APPENDIX B

RESPONSIBILITIES OF KEY PARTIES

The Administering Authority should:-

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the fund's actuary;
- prepare and maintain and FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the fund's performance and funding and amend FSS/SIP.

The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, excess ill-health early retirements if appropriate; and
- notify the administering authorities promptly of all changes to membership or, as may be proposed, which affect future funding.

The Fund actuary should:-

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

APPENDIX C

REMIT OF INVESTMENT SUB-COMMITTEE

The supervision and control of the operations and investments of the Orkney Islands Council Pension Fund including:-

1 Management of the investment of the pension and reserve funds, including the appointment and monitoring of investment fund managers.

2 Matters relating to the application of reserve fund monies, including the making of loans, but with the exception of the purchase of land and property within Orkney, where:-

(a) the return on any such disbursements is equivalent to, or greater than, the amount of interest which could reasonably have been expected to be obtained had the money been left with Investment managers;

(b) the investment is as risk free as possible; and

(c) it is ensured that funds from the Reserve Fund are applied to any purpose which "in the opinion of the Council is solely in the interests of the County and its inhabitants."

3 The determination of applications to the Renewable Energy Investment Fund, having regard to appropriate internal and external professional advice and the balance of risks and rewards involved.

APPENDIX D

SCHEDULED AND ADMITTED BODIES AS AT 31 MARCH 2011

Scheduled Bodies:

Orkney Islands Council

Admitted Bodies:

D & H Glue
Drinkwise Orkney
Golder Landscapes
Orkney Enterprise
Orkney Ferries Limited
Orkney Heritage Society
Orkney Islands Property Development Limited
Orkney Meat Limited
Orkney Opportunities Centre
Orkney Tourist Board (Visit Scotland)
Orkney Towage Company Limited
Pickaquoy Centre Trust
Weyland Farms Limited

APPENDIX E

CONTACTS

Orkney Islands Council
Enquiries relating to investment matters should be addressed to:

Gareth Waterson, Director of Finance & Housing or Colin Kemp, Asst Director of Finance
Orkney Islands Council
School Place
Kirkwall
Orkney
KW15 1NY
(01856) 873535

Enquiries regarding individual benefits, contributions or pensions in payment or requests for further information should be addressed to:

Bryan Hay
Pensions Manager
Orkney Islands Council
School Place
Kirkwall
Orkney
KW15 1NY
(01856) 873535

Other Contacts
In the event of a dispute, members have recourse initially to an internal disputes procedures and if still not satisfied to the Scottish Minister and in addition may contact the following bodies.

The Occupational Pensions Advisory Service (OPAS)
11 Belgrave Road
London
SW1V 1RB

This organisation is available to assist members and beneficiaries of occupational pension schemes in connection with difficulties, which they have been unable to resolve with the trustees or administrators of their scheme.

For problems that cannot be settled through OPAS, a Pensions Ombudsman (based at the same address as OPAS) has been appointed. The Ombudsman has power to investigate and determine complaints or disputes of fact or law in relation to occupational pension schemes. The Ombudsman can only become involved after a dispute has been to the Scottish Ministers.

Registry of Occupational Pension Schemes
PO Box 1NN
Newcastle upon Tyne
NE99 1NN

The Registry acts as a central tracing agency to help individuals keep track of any benefits they may have in previous employers' pension schemes. The Council's Scheme and the names and addresses of all current and previous participating employers have been registered with the Registrar.